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CURRENT STATE OF THE LIABILITY INSURANCE CRISIS

HEARINGS

BEFORE THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

ONE HUNDREDTH CONGRESS

FIRST SESSION

WASHINGTON, DC, APRIL 21, 28, AND 29, 1987

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CURRENT STATE OF THE LIABILITY INSURANCE CRISIS

TUESDAY, APRIL 21, 1987

House of Representatives,
Committee on Small Business,
Washington, DC.

The committee met, pursuant to notice, at 10 a.m., in room 2359-A, Rayburn House Office Building, Hon. John J. LaFalce (chairman of the committee) presiding.

Present: Chairman LaFalce; Representatives Mazzoli, Eckart, Olin, Bilbray, Mfume, Ireland, Slaughter, Meyers, Combest, Rhodes, and Gallegly.

Chairman LaFalce. The Small Business Committee will come to order.

This morning we will begin a series of hearings on the liability insurance crisis, which was deemed by the White House Conference on Small Business in August 1986 to be the most serious problem confronting the small business community of America. It would appear that the crisis in liability insurance is not yet over. Even though the insurance industry did experience increasing profits in 1986, a record $12.7 billion, which is over 600 percent more than in 1985, problems still exist with regard to the availability and affordability of liability insurance.

The crisis in affordability refers to the tremendous increase in liability insurance premiums. According to A.M. Best Co., an authoritative source on industry data, premiums for commercial liability insurance rose an average of 79 percent in 1985 and approximately 73 percent in 1986.

In many cases, we also found that premiums increased by as much as 300 to 1,000 percent in certain lines of insurance. A.M. Best reports that rates still appear to be going up briskly.

The crisis in availability refers to the inability of those who can afford to pay these higher prices to obtain liability insurance coverage at any price. A recent survey by the National Association of Insurance Commissioners reported that 39 States are still experiencing availability problems in 107 different lines of insurance. This problem is particularly acute, for example, in professional liability lines such as medical malpractice, and directors and officers; in products liability; and in environmental liability lines such as pollution and hazardous wastes.

Many States also report there has been no significant change in availability of liability insurance for daycare, nurse midwives, liquor stores, governmental entities, and truckers.

The impact of this continuing crisis in the American economy is particularly severe. Its impact is illustrated first by the sheer size of the insurance industry, which grossed over $350 billion in 1986, and accounts for approximately 12 percent of our gross national product. It provides more than 2 million jobs, and, at the end of 1985, had responsibility for protecting assets worth more than $1 trillion.

Its impact is also shown by the critical function which the insurance industry carries out, which is to absorb personal and business risks. If coverage of certain risks is not available or is prohibitively expensive, then businesses and individuals will not have the financial protection and security necessary for them to carry out their jobs. This situation endangers the efficient and sound functioning of the American economy.

This crisis has particularly harmed the financial stability of small business which either cannot obtain necessary lines of insurance coverage or can only obtain such coverage at exorbitant rates. Many small business owners are claiming that these problems are forcing them to change the way they do business. They say they have had to raise prices, cut back insurance coverage, and in some cases even tempt the fates by going bare, going without liability insurance coverage. All of these problems are what, I suspect, led the White House Conference on Small Business to proclaim in August 1986 that its top legislative priority for 1987 is to alleviate the liability insurance crisis.

This crisis is acquiring even greater dimensions as the pace of insurance company insolvencies increase. From 1969 to 1984, 84 admitted, fully licensed insurance companies collapsed. That was over approximately a 15-year period. But in 1984 and 1985 there were 41 insolvencies. There were 15 new insolvencies in 1986. If individuals and businesses are unable to recover their claims as a result of an insurance company insolvency, the stability of the economy is also negatively impacted.

Today's hearing will examine the current state of the liability insurance crisis regarding the availability and the affordability of liability insurance, as well as its impact on small business.

We are fortunate to have with us today, four distinguished witnesses who can speak with authority on these issues: Frank Swain, Chief Counsel for Advocacy of the Small Business Administration, who will present the findings from a current study of the impact of the liability insurance crisis on small business; Raymond L. Hayes, president of the National Association of Insurance Brokers and senior vice president of Rollins, Burdick, and Hunter, who will present the problems that still exist regarding the affordability and availability of liability insurance; Richard Reinhardt, president of PII Affiliates, Ltd., who is testifying on behalf of the National Federation of Independent Business. Mr. Reinhardt will present the findings of the NFIB regarding the problem of liability insurance for small business, and Ms. Barbara Balter, president of the Robert B. Balter Co., who is testifying on behalf of the National Association of Women Business Owners. Ms. Balter will discuss the White House Conference on Small Business and its recommended solutions to the liability insurance crisis.

Because of some time constraints of Mr. Swain, we will take him first and ask him questions, and then we will convene the other witnesses as a panel. I would ask Mr. Swain to come to the table, but before we call upon him for his testimony, I wonder if there are any members of the committee who wish to make any opening statement on this subject.

Mr. COMBEST. Mr. Chairman, I have a statement I would like to enter for the record.

Chairman LAFALCE. Yes.

Mr. COMBEST. Thank you, sir.

Chairman LAFALCE. Without objection, Mr. Combest's statement will be introduced into the body of the record. I would also like to place in the record a statement submitted by Hon. Stewart B. McKinney.

Opening Statement of Hon. Larry Combest, a Representative in Congress From the State of Texas

MR. CHAIRMAN, I AM DELIGHTED THAT THE SMALL BUSINESS COMMITTEE HAS UNDERTAKEN AN EXAMINATION OF WHAT MANY BELIEVE IS ONE OF THE GREATEST THREATS TO SMALL BUSINESSES TODAY -- LIABILITY INSURANCE PROBLEMS.

ALMOST EVERY FACET OF OUR SOCIETY IS AFFECTED BY THE LIABILITY INSURANCE CRUNCH, BUT THE IMPACT IS POSSIBLY FELT MOST SEVERELY BY THE SMALL BUSINESS COMMUNITY. I THINK IT IS MOST APPROPRIATE THAT WE REVIEW THIS ISSUE, PARTICULARLY IN LIGHT OF THE HEAVY EMPHASIS PLACED ON THE LIABILITY INSURANCE CRISIS BY DELEGATES AT THE WHITE HOUSE CONFERENCE ON SMALL BUSINESS LAST SUMMER.

THOSE OF US IN WEST TEXAS ARE FACING DIFFICULT ECONOMIC TIMES, AND THE BURDEN OF OBTAINING LIABILITY INSURANCE HAS EXACERBATED THE SITUATION TO THE CRITICAL POINT. AS I VISIT THE 19TH DISTRICT, MY CONSTITUENTS TELL ME FIRST OF THE BUSINESS HARDSHIPS POSED BY THE CURRENT CONDITION OF THE AGRICULTURE AND OIL AND GAS INDUSTRIES. DIFFICULTY IN OBTAINING AND AFFORDING LIABILITY INSURANCE VERY OFTEN RANKS SECOND ON THE LIST OF A SMALL BUSINESSMAN'S TROUBLES.

IN 1985, AMERICANS SPENT ON AVERAGE 60 PERCENT MORE IN LIABILITY INSURANCE PREMIUMS THAN THEY DID IN 1983. SOME INDUSTRIES HAVE SEEN INCREASES AS HIGH AS 300 PERCENT IN THE SAME PERIOD. DESPITE THESE ASTOUNDING STATISTICS, THE CAUSE OF THE LIABILITY CRISIS REMAINS UNCERTAIN. WHILE SOME BLAME THE INSURANCE INDUSTRY, OTHERS ARGUE THAT OUR SOCIETY HAS DEVELOPED A "TORT MENTALITY" EAGER TO GO TO COURT OVER ANY DISPUTE. WHATEVER THE CAUSE, IT IS CLEAR THAT SOME KIND OF REFORM IS ESSENTIAL.

MANY REFORMS WILL FALL TO THE STATES, WHERE AN ARRAY OF TORT REFORM BILLS MAY BE CONSIDERED. THE STATE LEGISLATURE IN TEXAS IS CURRENTLY WRESTLING WITH THIS DIFFICULT PROBLEM. ALTHOUGH THE STATES WILL PLAY A LEADING ROLE, THE INSURANCE DILEMMA HAS BECOME SO SEVERE THAT FEDERAL ACTION MAY BE NEEDED TO DEAL WITH CERTAIN PROBLEMS. IT IS MY DESIRE TO SEE THIS ISSUE HANDLED AS RESPONSIBLY AS POSSIBLE, AND I SEE THE OVERSIGHT FUNCTION BEING PERFORMED BY THIS COMMITTEE AS AN EXCELLENT MEANS OF ACHIEVING THE FACTS ABOUT THIS SITUATION AS IT PERTAINS TO SMALL BUSINESS.

I LOOK FORWARD TO HEARING WHAT OUR WITNESSES HAVE TO SAY. WE CAN HARDLY EXPECT OUR NATION'S SMALL BUSINESSMEN TO PROVIDE JOBS AND PLAY A VITAL ROLE IN ECONOMIC DIVERSIFICATION EFFORTS WHEN THEY ARE SADDLED WITH EXHORBITANT INSURANCE PREMIUMS OR WITH THE COMPLETE UNAVAILABILITY OF LIABILITY INSURANCE. I HOPE THAT THE COMMITTEE WILL BE ABLE TO ADDRESS THIS IMPORTANT AND SERIOUS ISSUE IN A MANNER THAT WILL UTLIMATELY REPRESENT THE NEEDS AND CONCERNS OF THE SMALL BUSINESS COMMUNITY SHOULD FUTURE CONGRESSIONAL INITIATIVES BE MADE TO RESOLVE THE LIABILITY INSURANCE CRISIS.

THANK YOU, MR. CHAIRMAN.

OPENING STATEMENT OF HON. STEWART B. MCKINNEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CONNECTICUT

Mr. Chairman:

I thank you for holding these hearings on the current state of the liability crisis and on the impact of this crisis on small businesses.

On March 24, 1986, I held a field hearing in Stamford, Connecticut on this same issue. The findings of this hearing substantiated my concern that increasing costs and a scarcity of liability insurance had created a national crisis for all sectors of the economy, especially small businesses.

As a result of this field hearing, as well as in response to the many angry letters I received from constituents, I introduced legislation which seeks to remedy the liability insurance crisis by attacking the product liability aspect of this problem. Briefly, my bill, H.R. 1599, contains the following provisions:

-- a general standard of liability is set as "a product in a defective condition unreasonably dangerous;"

-- injured parties would be unable to recover if their negligence exceeds that of the manufacturer;

-- an unreasonable misuse of the product would lessen the extent of the manufacturer's liability;

-- joint and several liability is only applicable when persons acting in concert are the proximate cause of the harm;

-- non-economic damages, including punitive, would be limited to $250,000;

-- A flagrant indifference to the consumer and an award of compensatory damages must be shown before awarding punitive damages;

-- periodic payments of future economic damages are allowed if consistent with the injured party's needs;

-- lawyers' contingency fees are limited;

-- the Attorney General is ordered to recommend alternative dispute resolution methods;

-- collateral sources of compensation are allowed to reduce the court award; and,

-- statutes of limitation and repose are included.

I applaud the committee's efforts to solve this crisis and I commend the chairman, once again, for holding these hearings. I strongly hope that these hearings will prod the 100th Congress into passing legislation which deals effectively with this terrible crisis.

Chairman LaFalce. Mr. Swain, we are pleased to have you before us as Chief Counsel for Advocacy of the SBA. We look forward to your testimony.

TESTIMONY OF FRANK S. SWAIN, CHIEF COUNSEL FOR ADVOCACY, SMALL BUSINESS ADMINISTRATION

Mr. Swain. Thank you, Mr. Chairman.

With your permission, I would request that my statement be received in the record, and in an effort to expedite matters so that we can get to the other witnesses as well, I will simply summarize the key points of our written statement.

Certainly you and the members of the committee are to be congratulated for convening a set of hearings on this, the No. 1 issue for small businesses, as I think quite appropriately determined by the White House Conference on Small Business last August.

What we present to you today is some new, or at least some updated information, we hope. The Office of Advocacy has commissioned a specific research project to examine the impact of the insurance crisis on small versus large business to try to get beyond some of the anecdotal evidence that, as your opening statement indicated, has been quite persuasive, but nonetheless to try to get beyond that and into a better understanding of the whole issue. And we will review basically the preliminary findings of that study, as well as reviewing a survey that our office did within the last 2 weeks of companies that called us over the past year and had insurance problems, and our attempt to update their experience.

As you are well aware, the shortage and high cost of liability insurance has had a devastating effect on small companies. Certain small businesses, such as day care providers and companies handling hazardous waste, have found themselves unable to purchase coverage at any price. Other businesses, including manufacturers, truckers, recreation places, have found that insurance is available, but the premiums have increased since 1984 by 100 percent or in some situations as much as 1,000 percent.

Now, why is this a particular problem for small business? A couple of reasons. First, small businesses are usually in highly competitive environments, so any increase in a necessary cost—and liability insurance is certainly considered by most people a necessary cost—is an overhead expense that is oftentimes difficult for small firms to pass on to customers as easily as some larger firms that have more financing flexibility.

Second, small businesses which purchase less protection and fewer lines of insurance than large businesses may well have less leverage in negotiating favorable rates from insurers. Insurers do not base rates on the previous loss experiences for the specific businesses, but there is a general rating. So, therefore, small businesses, we feel, are somewhat disadvantaged by that.

And finally, small businesses, generally, find self-insurance or being members of a group insurance pool a less practical alternative, again primarily for financing reasons, than several large companies who, particularly within the last several months, have initiated several major self-insurance or group insurance pools.

It will be interesting to see whether small firms resolve some of their insurance problems by utilizing the group insurance arrangements permitted by the Risk Retention Act that was enacted by the Congress last year that broadens the ability of all firms to form risk retention pools.

At any rate, now to the study. Basically, the study performed by Abt Associates of Massachusetts was a survey of over a thousand companies in Massachusetts. The survey was conducted in August 1986 at about the height of the insurance crisis, and what we asked Abt to do was specifically, to segregate out the experience of smaller companies to larger companies.

Small businesses in virtually all industries reported that the high cost and scarcity of liability insurance had had a great impact on their profitability or their ability to deliver services. And we attached the specific tables to show the breakdown on an industry by industry basis.

I believe that one of the most dramatic findings of the study relates to the claims experience of small firms as compared to large firms. The study shows that in every industry surveyed, smaller firms were significantly less likely to have had a liability claim of $1,000 or more during the last 5 years. This finding suggests to me, at least, that whatever the cause of the high cost and scarcity of liability insurance, it does not appear to be the actual claims records of small firms.

The research also reveals that in addition to the problems with specialty lines of insurance, which have received much attention, including product liability, environmental insurance, medical malpractice, errors and omissions, and so on, for many small businesses, obtaining general liability coverage continues to be a problem. And that was reported in a number of industries.

Chairman **LaFalce**. Mr. Swain, before you go any further, let me just clarify. This is all based upon the Abt study. And when was the Abt study again?

Mr. **Swain**. Survey responses were received in August 1986.

Chairman **LaFalce**. So, this is still August 1986 information.

Mr. **Swain**. That is right.

Chairman **LaFalce**. All right. Thank you.

Mr. **Swain**. The preliminary results also show that in services, construction and retail industries, smaller firms were more likely to have faced a premium increase of 100 percent or more between 1984 and 1986. In contrast, none of the larger companies in any of those three industries reported a premium increase of that magnitude.

The preliminary results of this study suggests to us that during August 1986, which I think was probably around the height of the tight insurance market, businesses of all sizes were experiencing substantial problems with nonrenewals, cancellations, premium increases, and inadequate coverage. However, small businesses appear to have been less able to respond to these insurance problems and reported that they are experiencing the greatest impact despite the fact that they are significantly less likely to have experienced claims.

Now, the second part of our statement, in an attempt, as much as possible, to get a current, present-day reading, our office attempted to keep track of businesses that would call us over the course of the past 12 months or so to report insurance problems and ask what they could do about it, or ask some sort of help.

And in the last 2 weeks, we had people in our office call each of those companies back that we had been able to track down. And unfortunately, the results indicate that although there has been some stability—stabilizing in the sense that insurance seems to be somewhat more available now than it was a year ago, the stability has come at a relatively high premium rate. In other words, there have not necessarily been 40 or 50 or 100 percent increases 1986 to 1987, but the rates are still at the very high level from 1986.

We cite several specific examples in the statement of companies that, despite very good claims records, have had tremendous increases in their rates. We think that high rates continue to be a problem for some small businesses. One might argue that the situation is improving to the extent that rates have not gotten dramatically worse, 1987 over 1986, but by all accounts at the White House Conference, rates were at a very deeply disturbing level in 1986. And we have very little information to indicate that that has significantly abated.

We will be happy to make the preliminary results of the survey available to the committee. We expect that a second phase of the survey——

Chairman LaFalce. Preliminary results of what survey?

Mr. Swain. The Abt survey that I quoted in my statement.

Chairman LaFalce. Of August 1986?

Mr. Swain. That is right. They did the survey. We are paying them to analyze the information. They have sent us the preliminary results because we requested it in time for this statement. I am simply saying that the final report, all clean and signed off on as a completed contract, will not be available yet. I would be happy to let you see what we do have at this point.

The second phase of the study that they are doing is a survey of trade associations in the effective product lines to see what their experience has been. We do not have that aspect of the results in yet. And as soon as it does come in, we will be happy to share it with the committee.

Chairman LaFalce. Is that your statement?

Mr. Swain. That is my statement.

Chairman LaFalce. Thank you very much, Mr. Swain.

[Mr. Swain's prepared statement, with attachments, follows:]

PREPARED STATEMENT OF FRANK S. SWAIN, CHIEF COUNSEL FOR ADVOCACY, SMALL BUSINESS ADMINISTRATION

Mr. Chairman:

Thank you for the opportunity to testify before the Committee on an issue which is absolutely crucial to the small business community--the availability and affordability of liability insurance. As you know, the number one recommendation of the 1986 White House Conference on Small Business was to alleviate difficulties in obtaining adequate and affordable insurance.

The insurance issue is a top priority for the Office of Advocacy. Currently we are funding a research project to examine the impact of the insurance crisis on small versus large firms. I would like to describe some of the preliminary results for you today. In addition, I would like to relate the progress of small businesses who have contacted our office with problems in obtaining insurance. This month, the Office of Advocacy conducted a series of follow-up calls to businesses who had reported severe insurance problems in late 1985 and early 1986. I think that you will find the results of the follow-up calls encouraging.

1. Impact of the Insurance Crisis on Small Business

As you are well aware, the shortage and high cost of liability insurance has had a devastating effect on small companies. Some businesses, such as day care providers and companies handling hazardous wastes, have found themselves unable to purchase insurance coverage at any price. Other businesses, such as manufacturers, restaurants, truckers, and roller skating rinks have found that insurance is available but that premiums have increased since 1984 by 100 percent or, in some situations, as much as 1000 percent. In many cases, deductibles have increased sharply and policy coverage has been reduced by as much as 30 to 50 percent.

Small businesses are particularly affected by liability insurance shortages for several reasons. First, many small firms in competitive environments find it difficult to pass on higher premium costs to consumers. Most small businesses operate on a very moderate cash flow and must pay for higher insurance premiums by limiting business expansion or reducing payroll or other operating expenses. Ultimately, high insurance costs for small business may impede business growth, job creation and innovation.

In addition, small businesses may have particular difficulties as consumers of insurance. Small businesses, which purchase less protection and fewer lines of insurance than large businesses, may have less leverage in negotiating favorable rates from insurers. Many insurers do not base rates on previous loss experience for smaller businesses, which may penalize small firms with a healthy claim history. Small companies do not usually have in-house experts, "risk managers," whose sole duty is to purchase insurance and to assess and manage risk. Finally, small firms interested in finding alternatives to commercial insurance are less able than large businesses to protect themselves by self-insuring or contributing to a group insurance pool.

It will be interesting to see whether small firms, to resolve their insurance problems, utilize the group insurance arrangements permitted by the Risk Retention Amendments of 1986 (RRA), P.L. 99-573. The RRA enables businesses needing liability insurance to form insurance pools or purchase commercial liability insurance policies in groups. The current SBA study will examine trade associations' efforts to promote group insurance vehicles. This part of the study will be available in late spring.

2. Preliminary Results of Abt Study[1]

The Abt data support several conclusions about the impact of the insurance crisis on small businesses. While businesses of all sizes have experienced difficulties, small businesses have reported greater financial impact in responding to insurance deficiencies.

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[1] Abt Associates, Inc. are currently under contract (Award No. SBA-2016-AER-87) to prepare a report entitled "Liability Insurance Coverage and Losses in Small Compared to Large Businesses." The study consists of two parts: (1) an analysis of data collected on a sample of 1018 businesses in Massachusetts during August 1986 and (2) a survey of selected trade associations. The study is expected to be completed by late spring. The preliminary results provided here are based on the analysis of the Massachusetts survey data.

Small businesses in virtually all industries reported that the high cost and scarcity of liability insurance have had a great impact on their profitability or ability to deliver services (see Table 1 attached). This is particularly true for day care centers, which are almost all small businesses, and bars and restaurants. For example, 33% of day care centers with less than ten employees and 25% of those with 11-49 employees reported a severe financial impact on their business operations. Similarly, for bars and restaurants, 46% of those with ten or less employees and 25% of those with 11-49 employees reported comparable effects.

One of the most dramatic findings of the study relates to the claims experience of small as compared to larger firms. The study shows that in every industry surveyed, smaller firms were significantly less likely to have had a liability claim of $1000 or more between 1981-1986 (see Table 2 attached). This finding suggests that whatever the cause for the high cost and scarcity of liability insurance, it does not appear to be the claims experience of small businesses.

The research reveals that in addition to the problems with speciality lines of insurance which have received much public attention (product liability, environmental impairment, malpractice, and errors and omissions) obtaining general liability coverage continues to be a problem for many small businesses. In a number of industries, small employers reported deficiencies in primary general liability coverage (see Table 3 attached). These businesses were involved with recreation and sports, manufacturing, day care and construction.

In examining specific insurance administration problems such as non-renewals, mid-term cancellations and premium increases, the survey shows that small businesses in some industries are having greater problems than larger businesses. The reverse, however, appeared to be true in other industries. For example, day care providers and small bars and restaurants were more likely to face an insurance company's refusal to renew their policy. On the other hand, larger concerns in the manufacturing and construction industries experienced greater problems with non-renewals. Mid-term cancellations of policies were more prevalent among small businesses in the construction industry while larger businesses in retail and manufacturing were more likely to experience such cancellations.

The preliminary results also show that in the services, construction and retail industries, smaller firms were more likely to have faced a premium increase of 100 percent or more between 1984 and 1986. In contrast, none of the larger companies in any of these three industries reported an increase of that magnitude.

Finally, in many lines of business, smaller firms were more likely to have responded to their insurance problems by dropping services. For example, as Table 4 shows, smaller design professionals and construction firms were significantly more likely to have dropped services than their larger counterparts.

The preliminary results of the Abt Study suggest that during August 1986, around the height of the tight insurance market, businesses of all sizes were experiencing substantial problems with non-renewals, cancellations, premium increases and inadequate coverage. Small businesses, however, appear to have been less able to respond to these insurance problems and reported that they are experiencing the greatest impact, despite the fact that they are significantly less likely to have experienced claims.

3. Cases Reported to Office of Advocacy

For some small business owners, insurance difficulties, which worsened significantly from 1985-1986, have recently begun to stabilize. More businesses are finding that new policies are available at about the same price, albeit a high one, as the previous (1985) renewal.

One business reported a decline in premiums for the same amount of coverage. J.L. Hose, Inc., a manufacturer of low volume air hoses in Philadelphia, PA, paid a $5,400 premium in 1985 for $1 million worth of coverage. In 1986, its premium increased to $13,889 for only half the coverage ($500,000). The current 1987 policy has an $7,500 premium for the same $500,000 of coverage. The company attributes its lower premium to an on-site inspection it requested from the insurance carrier.

Many small businesses, however, are facing still higher premiums for less coverage, and some are finding that the same amount of coverage continues to cost them more. C&W Mechanical Contractors in Old Zionsville, PA had a 1985 rate of approximately $4,600 for a $5 million package of auto liability, worker's compensation, general liability, and an umbrella policy. As of this year, its rates have increased to $32,000 for $500,000 of liability coverage only.

In addition, a few cases have been reported to us of small companies being forced out of business because insurance was unaffordable or unavailable. Formerly a mechanical contractor, Herbert Tolliver from Heiskell, TN needed $500,000 of liability coverage to compete for contracts. Because he could not find a policy, he had no choice but to go out of business. An individual in Napanoch, NY needed a commercial truck and cargo policy to go into business for himself. He sold his truck when the only available insurance policies were unaffordable.

Finally, a few small businesses have indicated that they are operating without insurance. A manufacturer in the semi-conductor industry in New Jersey was unable to get product liability insurance at any price, and reports that he is continuing to operate without insurance.

Overall, however, the Office of Advocacy is receiving far fewer insurance complaints than a year ago. Small businesses, for the most part, are finding insurance policies and managing to shoulder the higher costs. They also appear better prepared to budget for increased insurance expenses.

The good news, therefore, is that in 1987 insurance seems more available and prices more stable. Unfortunately, however, those prices have stabilized at relatively high rates. Higher insurance costs will continue to affect the ability of small businesses to deliver products and services, create jobs and provide innovation. Until a long-term solution to the problem of high cost insurance is found, small businesses will be putting more time and dollars into obtaining liability insurance and viewing insurance as a significant, if not primary, factor in making business planning decisions.

We urge this Committee to continue to examine this important small business problem, focusing on both the insurance industry and civil justice reform aspects of the problem.

Thank you for the opportunity to address the Committee. I would be happy to answer any questions.

TABLE 1

Percentage of Businesses in Size/Type Categories Who Reported That Their Responses to Insurance Deficiencies Had "Great Impact" on Their Profitability or Ability to Deliver Services

Type Of Business	Number of Employees <10 (%)	11-49 (%)	50+ (%)	All (%)
Family Day Care Providers	33	--	--	33
Day Care Centers	33	25	--	29
Manufacturing	0	18	13	11
Services	17	60	0	27
Design Professionals	29	37	17	30
Construction	39	11	20	26
Retail	0	100	0	17
Recreation/Sports	46	14	33	30
Bars/Restaurants	46	25	0	35
Hotels/Motels	0	0	33	12
Other Professional Services	20	0	25	17

Source for Tables 1-4: Abt Associates, Inc. (Cambridge, MA) research in progress under contract (Award No. SBA-2016-AER-87) to prepare a report entitled "Liability Insurance Coverage and Losses in Small Compared to Large Businesses."

TABLE 2

Percentage of Businesses in Size/Type Categories Which Experienced a Liability Claim of $1000 or more Between 1981-1986

Type of Business	Number of Employees			
	<10 (%)	11-49 (%)	50+ (%)	All (%)
Family Day Care Providers	0	0	--	0
Day Care Centers	0	0	--	0
Manufacturing	5	14	42	16
Services	10	21	25	14
Design Professionals	9	31	64	25
Construction	4	30	100	20
Retail	3	9	25	5
Recreation/Sports	21	45	50	34
Bars/Restaurants	8	15	27	15
Hotels/Motels	6	21	55	20
Other Professional Services	9	11	75	13

TABLE 3

Percentage of Firms in Size/Type Categories Who Perceive Themselves Deficient in Primary General Liability Coverage

Type of business	Number of Employees			
	<10 (%)	11-49 (%)	50+ (%)	All (%)
Family Day Care Providers	30	0	--	29
Day Care Centers	29	14	--	21
Manufacturing	14	0	0	5
Services	4	11	0	5
Design Professionals	9	5	0	6
Construction	21	8	12	16
Retail	0	0	0	0
Recreation/Sports	15	16	0	14
Bars/Restaurants	8	4	0	5
Hotels/Motels	0	4	8	3
Other Professional Services	0	6	0	1

TABLE 4

Percentage of Businesses in Size/Type Categories With Insurance Deficiencies Who Responded by Dropping Services

Type of Business	Number of Employees <10 (%)	11-49 (%)	50+ (%)	All (%)
Family Day Care Providers	0	0	--	0
Day Care Centers	0	0	--	0
Manufacturing	0	33	13	17
Services	33	0	25	20
Design Professionals	29	32	17	28
Construction	23	11	0	15
Retail	25	0	0	17
Recreation/Sports	8	46	0	22
Bars/Restaurants	15	0	50	13
Hotels/Motels	0	17	0	6
Other Professional Services	20	0	25	17

Chairman LaFalce. Let's get serious. Of what value are these various surveys that you have conducted? I mean of what validity would they be if one were examining a body of evidence? If you had somebody who was an expert on the use of data, what would they say of the quality of the data that is presented in a survey? Is it adequate enough for us to use as a basis for intelligent public policy judgment?

Mr. Swain. I certainly hope so, Mr. Chairman, or else I would not be spending the taxpayers' money to buy the information in the first place.

Chairman LaFalce. OK, well, then I fundamentally disagree with you because I think it is almost a waste of the taxpayers' money. The problems that I have had over the years is that we get a million and one of these so-called surveys, and they are anecdotal information at best. You were calling over the last 2 weeks to businesses to find out how they are doing. I am sure you would not——

Mr. Swain. Well, that certainly was at random. Yes; very random.

Chairman LaFalce. But even take the Abt survey now. They are going to go to the trade associations. And what do the trade associations do? They go to their members. And it is a very hit and miss type of affair. It can give you a rough idea. People believe what people believe. And they start repeating stories that other people give you, et cetera.

I just do not know if Congress should be trying to make public policy judgments about a very serious problem confronting the small business community unless we have better data. I am just wondering if you have come to any conclusions as to the need for the Small Business Administration, the need for the Federal Government, the need for State governments, the need for the Congress to have a better body of data in order to make intelligent public policy judgments?

Mr. Swain. May I respond to your comments on the survey?

Chairman LaFalce. Sure.

Mr. Swain. As I mentioned, the survey is in two parts, one part which we outlined in our statement, which is a statistical survey based on the sample of over 1,000 companies in one State, one set of local State insurance regulations. And I am not a statistician myself, but I would stand by the statistical validity of that survey. We have mentioned the highlights where we felt that—our statisticians felt that the sample size was large enough to adequately and accurately portray the phenomenon. Where it was such a small sample size, we are not pressing the results further than we feel is statistically appropriate. And I do stand by the results of that survey.

Frankly, the survey doesn't make any news. I don't see how anybody could disagree with it that small firms continue to have problems obtaining coverage, and their problems seem to be more acute than large firms.

I do agree with you that, obviously, a survey of the trade associations is going to have a certain degree of subjectivity to it. But the problem that we have had—and you are certainly much more knowledgeable about the issue than I am—is just as you have stated, that we have had an exceedingly high degree of anecdotal evidence. So, you may say to me that my survey is not up to some certain standards. I would disagree with that. But something is better than nothing. And I would say that we have had pretty much nothing in terms of a survey or analysis such as this.

Chairman LaFalce. Yes; I suppose something can be better than nothing if the something is properly interpreted. But if that something is improperly interpreted and improperly used, it could be worse than nothing.

Mr. Swain. Well, I would welcome the committee's suggestion as to whether the survey has been adequately or properly interpreted by us. I would state that we interpreted to you this morning the results that we were confident of, and we have not pushed the data.

Chairman LaFalce. If your basic interpretation is that the survey concludes that small businesses have a serious problem with the availability and affordability of insurance, I would have no quarrel with that. And if your second basic conclusion is that small business is more adversely affected than large businesses because of the liability insurance crisis, I would have no quarrel with that whatsoever. I accept those almost as givens.

Where do you go beyond that, though? What do you do about the problem? Well, you need more concrete evidence, better data, to go beyond the realization that there is a problem that is more severe for small businesses in determining what legislative remedies you might or might not fashion. That is the point I am trying to make, Mr. Swain.

I have no quarrel with your survey for the limited purpose of establishing the fact that small businesses have a problem that is a serious problem and a more serious problem than large businesses. My problem is doing something about it, and I do not know that we have an adequate enough data base to do anything about it, which is one of the reasons why we may be proposing a bill that would provide that adequate data base. So, if you are wondering where I am coming from, I have now led you to that point.

Maybe we need a better data base. Maybe we need to mandate that data base by Federal law to be provided by State commissioners, or maybe a data base to be collected by the Federal Government itself. I am not sure, but I would ask you just to consider that in the future.

Mr. Swain. Well, just a general comment, Mr. Chairman.

It seems to me that in order to inquire about this issue, there are three possible sources of information, if you are talking in terms of a survey. What we did was we surveyed small businesses. One could also obtain information from or about insurance carriers themselves to go to the issue of losses and underwriting and so on. And, obviously, there have been a lot of surveys and studies also done, as you well know, on actual court records. And they are, all over the map. I did not come in here this morning as an expert on those particular studies. But we in the Small Business Administration surveyed small businesses. Perhaps you are correct that more investigatory work needs to be done. I would be happy to work with the committee, whatever your suggestions are.

Chairman LaFalce. Mr. Olin.

Mr. Olin. Thank you, Mr. Chairman.

I wanted to ask Mr. Swain a little bit more about the conclusions of the Abt study. From that study were you able to reach any conclusions with regard to what had happened to the effectiveness of competition in the insurance industry as related to their service of small business?

Mr. SWAIN. The straight answer to your question, Congressman Olin, is that the study itself does not give us specific information about competition. It does tell us that a lot of small companies apparently have a hard time buying insurance.

And there may be a lot of reasons for that. Some of them may be that the market is pretty tight in some of those product lines. But as to the reasons for that, our study does not give——

Mr. OLIN. Your study was not structured really to determine much about the cause of the problem. You determined that it existed, but of course, as the chairman has said, that was evident from the outset.

Mr. SWAIN. We tried to determine what parts of the problem were most onerous, whether it was availability at all, which does not seem to be so much the case any more; whether it was increased cost, which seems to be very much the case; whether it was problems of administration, nonrenewal, mid-term cancellation, that sort of thing. That seems to be lessening. So, we tried to understand a little bit more what is happening. There is, certainly, much further to go. I do not disagree with the chairman at all on that.

Mr. OLIN. You alluded to the fact, as I took it, that the small businesses, at least related to experience, were paying considerably higher rates than larger businesses——

Mr. SWAIN. Yes, sir.

Mr. OLIN [continuing]. Based on that analysis.

Did you discover or did you conclude that there were possibly some improper pricing practices being used with regard to that discrimination between large and small?

Mr. SWAIN. Well, I think our general conclusion would be that large firms are experience rated; small firms are not experience rated, that is that the specific claims record of the small business does not seem to bear very much relationship to their price of their coverage. And so, therefore, small firms, because they seem to be thrown into a pool, are at a disadvantage in negotiating better insurance rates.

Mr. OLIN. This Abt study, which was of a period in August, during what time did the interviewing take place?

Mr. SWAIN. August 1986.

Mr. OLIN. In August.

Mr. SWAIN. Yes.

Mr. OLIN. Then it took from August till now to obtain the final conclusions of their study?

Mr. SWAIN. Well, I believe we signed the contract with them in November, and basically, we paid them to do some work on the data that they had not previously done in the statistical analysis. It has been about 3 months, and we have the preliminary results for you today.

Mr. OLIN. It strikes me that with an issue that is as hot as the No. 1 target at the White House Conference, and, of course, all of us that are acquainted with small business understand the burden that this has placed on small business, with a number of firms going under literally because of the cost of insurance, that we could have been a little more expeditious in picking an outfit that had the capability to produce some results that would lead to some conclusions that could be translated into public policy.

Mr. Swain. Well, if you want me to report the process by which we picked them, I would be happy to do so. I do not know how much the committee wants that information. We had a request for proposals. As you know, the Commerce Business Daily Act and other laws require that the request be out a certain amount of time. We had them technically reviewed. The Abt proposal was ranked No. 1 by our technical review committee, and we signed the contract with them and got it going just as quickly as we possibly could. It should have been faster. I will admit that.

Mr. Olin. It almost sounds, Mr. Swain, as though the preliminary report was obtained in time to be presented at this meeting, and that perhaps the telephone survey was actually stimulated by this meeting.

Mr. Swain. Oh, it was. It was. There is no question.

Mr. Olin. You might reach the conclusion that the SBA perhaps was not as diligent in pursuing something of this importance as it could have been.

Mr. Swain. I cannot agree with that conclusion, Mr. Olin.

Mr. Olin. The evidence seems to be contrary.

Thank you, Mr. Chairman.

Chairman LaFalce. Mr. Ireland.

Mr. Ireland. Thank you, Mr. Chairman.

We have already spent, and I guess we will spend some additional time talking about whether we have adequate data or enough information. I recall about 10 years ago, when I first came to the Congress, that you, Mr. Chairman, held several hearings concerning liability insurance. Now if I were a small businessman, I would be sitting out in the audience, and saying. "My God, these guys want to study this some more. Doesn't anybody have any solutions?"

I am persuaded there is a problem, yet I feel like I am swamped with data. Are there any ideas at the SBA concerning what can be done about it, or suggestions for us to look at?

Mr. Swain. Well, the major solutions, I think, were those that were identified by the No. 1 recommendation to the White House Conference on Small Business, which is a recommendation that has at least a threat of every possible approach to the issue, the principal approach being reform at both the Federal and State level, various reforms in the civil justice system, as well as some greater information gathering on the industry itself.

Mr. Ireland. Thank you.

Mr. Chairman, I think that sends us a signal. The White House Conference told us that there is a problem. We have known it from your hearings in the past, and it has been in the papers. We must begin paying attention to solutions. Maybe we make a mistake with our solution, but for most small businesses a mistake in our solution cannot be worse than what they have now. I would urge that we move on to solutions.

Thank you.

Chairman LaFalce. Thank you.

Mr. Bilbray.

Mr. Bilbray. Yes; Mr. Chairman.

Mr. Swain, a problem that my constituents call me constantly on is the fact that there is such a narrow base in certain areas. You mentioned day schools and so forth. I have found also that small motel owners that have restaurants attached have told me that a few years ago there might have been 15 companies in my district that insured that type of business. Now it has narrowed down to maybe one or two. Therefore, competition is no longer there, and the rates with the two remaining are very, very high.

Has the SBA looked at a solution? You know, maybe it is a State's rights issue. I am not sure because I talked to Mr. Lancaster earlier that most of the States are working on the same problem. Maybe it is a Federal issue. But how do we expand the base? It is like an airline. If you have only one airline flying into a small town, the rates are real high. If you have 10 flying into an area, they are all in competition. The rates drop. Has any work been done on a solution in this area because that seems to be the problem? There is a lack of competition in certain areas that is just killing these small businesses that are in certain classifications.

Mr. Swain. We would agree with that, Congressman. I do believe that the specific number of carriers that is available in a State is probably much more dependent on the insurance climate in that particular State. And just as the papers have been full of stories locally about certain carriers pulling out of certain States for certain coverage, there does seem to be a small trickle of stories in the insurance trade press about where States have taken some actions of a reform nature, carriers are beginning to come back in.

But I suspect—and I am not a spokesman for the insurance industry and have no particular knowledge, but I suspect that when a company decides whether to sell policies of a certain kind in Nevada or whether to pull out of that area in general, they take a look at their loss record in that State, and as you indicate, where there may not be a lot of records one way or the other, they may look at other things as well. Obviously the tort climate and other factors.

There is no way in our system to require somebody to sell insurance to a particular person unless one comes up with some sort of pooled risk sort of thing which is the case in most States in auto policies. But clearly the entire insurance climate has to be improved before carriers go back in the States that they have abandoned for whatever reason.

Mr. Bilbray. Maybe $12 billion last year in profits is not a large amount in this industry. And having not been on the committee over the last 10 years, I do not know what kind of profits they were making 4, 6, or 8 years ago. But it seems like the profits are still there. The companies are doing fairly well. And yet the rates seem to be escalating out of sight.

I know even in my law practice before I came, the malpractice rates have just escalated in law practices that do not deal in SEC work, and do not deal in areas that have high potential for claims.

And it is just killing everybody, and it just seems like the profits are big, but maybe you can answer that.

Maybe that is not—for us new members, maybe that is not a great deal of profits for the company.

Mr. SWAIN. Well, again, I am not the expert on the profit figures. There are, basically, two kinds of profit figures that most people cite, which are the general total profits of a carrier which takes into account both their underwriting activities as well as investment income, real estate, whatever, everything else that these financial conglomerates use as income streams now, and the profits in specific underwriting lines.

I think that, generally, an examination of profits in specific underwriting lines seems to indicate that there are a couple of lines that are not doing too badly. Homeowners and automobile liability, for instance, and there has not been a crisis in those two lines of insurance.

The evidence on what exactly the profits are in the other lines from my general knowledge of it is very mixed, subject to varying interpretations and not at all precise. So lots of people argue about that.

Mr. BILBRAY. Well, the reason I am asking that is if the survey was done and showed that certain areas were not covered because the profits were not big enough, maybe they were making money but they were not making enough. Maybe we need Federal incentives to urge companies to go in the areas; maybe they are not making 15 percent profits or 10 or 9 or whatever it may be. But maybe if there were some Federal incentives for companies to enter areas of lower profits because of other incentives that were there from the Government, to do so would encourage more competition in these areas and maybe we could drive the rates down. Because it seems like every time we get into a fight over restricting liability, it becomes a blood bath, and maybe there are other methods of doing this by encouraging competition by some sort of tax incentives or other incentives from the Government to do so. I do not even know if anybody has looked at this or thought about it.

Mr. SWAIN. Well, I certainly think in the tax incentive area, as long as you raised that, the tax incentives are not that great for a company that does not have insurance to self-insure, and there probably could be a look at—looking at broadening the tax incentives for self-insurance, because a small company that is faced with a high premium if a company owner could say, "Well, I will just look at my own losses for the first $100,000 and buy umbrella coverage," they may be in a better situation.

But the tax law has been somewhat liberalized for self-insurance but there probably could be some further easing of the rules for accumulating a pool of money to pay off an insurance claim and making that more advantageous from a tax perspective.

Mr. BILBRAY. Thank you.

Chairman LAFALCE. Any questions, Mr. Mfume.

Mr. MFUME. Thank you, Mr. Chairman.

Mr. Swain, let me say good morning first of all, and thank you for your testimony.

Let me border a bit on redundancy and follow up on the queries of a couple of my colleagues. After the SBA gets the results of this study, as you have gotten with other studies, can you tell us what the SBA sees as its role during the interim to try to offset or to try to cushion the effects of the problem?

And do you have within your own infrastructure the wherewithal to alert small businesses ahead of time to provide, through an informational dissemination of facts, certain things that they ought to be aware of before they seek to expand or to merge, before they consider going into different areas, different products?

In other words, do you take what you have and try to arm them?

Mr. **Swain**. Well, the role of our particular office, Congressman, the Office of Advocacy, is primarily a public policy role to try to understand as specifically as possible about the impact of these various problems on small business and to let other people in Government, principally the Congress, know of our work on that and to urge various changes in the system.

There is, of course, the major role of the agency as a whole to aid and counsel small businesses. And the agency has a series of programs in which they attempt to provide various kinds in various ways management counseling to small businesses, and alert them of various problems coming up.

I believe that within the last couple of years the SBA has cosponsored some public television problems on various aspects of insurance, and some of the more hazardous waste insurance issues. We have management publications that, I believe, discuss what every businessperson ought to know about insurance.

In terms of what we do, it is certainly, I would suppose, of a general nature. And for instance, we would have a small business development center, or a small business institute, or SCORE Program in your city, offering specific responses to small businesses who have questions. But, obviously, the questions and responses vary a lot city-by-city.

The major focus of the agency is to provide counseling and assistance to small businesses that have certain problems. But I will tell you right now the answer that we specifically give a small business owner when he calls and he says he has problems with his insurance is basically, we try to give them some indication of whether they have asked the right questions about deductibles, whether they have shopped around among various agents and carriers, whether they have looked at their trade association to see whether the trade association may have some sort of in-house program that would offer some sort of guaranteed coverage.

We do try to lead them through some basic areas when we do get the inquiries.

Mr. **Mfume**. Do you make referrals also to particular carriers who may be offering better rates in different areas?

Mr. **Swain**. No, sir; well, I would say not to my knowledge.

Mr. **Mfume**. I know you are not in that business.

Mr. **Swain**. I am sure it has been done from time to time, but we do not——

Mr. **Mfume**. But would it be a good idea?

Mr. **Swain**. No; we do not have any central repository of which carriers are offering the best rates in certain areas. If we happen to hear that there is a real problem with daycare in *x* number of States, but some company has come in and started to come in and cover those companies, then we certainly would pass that information on.

Mr. MFUME. Would the SBA consider, entertain at least, the idea of publishing to your membership or to businesses that you are in touch with, a list on a month-to-month basis of different companies and what their rates may be? And then to notify those companies that they are being published. At least I would think that if they know that and they are in a competitive market, maybe that would be some incentive, again, during this interim to try to do something about cleaning up their act.

Mr. SWAIN. I think that is an excellent idea. To be honest, I am not sure that the SBA is the best one to do it and I am not trying to get away from your question. There are a number of consumer publications that do that in certain lines of insurance. I think there are some industry associations that have some sort of rate quotations, but I am not an expert on the industry.

All I know is that when I go buy my auto insurance, I have a devil of a time figuring out what the best rate is.

Mr. MFUME. Well, if you get the information, can you give it to us? We will get it around.

Mr. SWAIN. Well, we certainly will look into it. Yes, sir.

Mr. MFUME. OK, thank you.

Thank you, Mr. Chairman.

Chairman LAFALCE. Thank you.

Are there other questions? Ms. Meyers.

Ms. MEYERS. I read someplace that the insurance crisis had passed. I mentioned this at a meeting of businessmen at home, and they said that that really was just not the truth; that the insurance crisis, to their way of thinking, has not eased.

I think the thing that surprised me about the White House Conference and maybe a little bit about your testimony this morning, and I would like to have you comment on this, is that in the past when we talked about the liability insurance crisis, most of the suggestions focused on tort reform, on suggestions of timely filing, or inability to file if the product was state-of-the-art, or limits on awards, or limits on attorneys' fees, something that had to do with the tort reform aspect of it.

You seem to be indicating, and the first thing mentioned in the White House Conference of Small Business seemed to indicate that the focus is on the insurance industry itself, with the principal suggestion being the repeal of the McCarran/Ferguson Act. I would like you to comment on that.

Mr. SWAIN. Thank you.

My statement was an attempt to be responsive to the committee which was to inquire about the extent of insurance problems for small businesses. And it might have been a lot longer and I might have studied a lot harder if I was specifically asked to address all of the various solutions which I would be happy to address either formally or informally at another forum, whatever.

But the statement really should not be read as focusing on the insurance industry to suggest that everything is wrong with the insurance industry, and the solution is to change the industry somehow and not to change tort reform. We just did not speak to the solution issue. We were asked to speak to the problems and we spoke to the problems.

I would certainly agree with the focus of the No. 1 recommendation of the White House Conference on Small Business; that tort reform is a key policy issue that State legislatures and, I think, the Congress ought to confront.

On your question on McCarran/Ferguson, I do not think that there is any reason from an antitrust standpoint, from an antitrust policy standpoint, to have an exemption for the insurance industry, but I am not really sure that changing the McCarran/Ferguson Act is going to solve this problem. It may well help in some ways, but I do not see it as a panacea.

But I certainly see that there is no particular reason to, in a general sense, to have that exemption unexamined.

Ms. MEYERS. Would you agree that the White House Conference seemed to focus on repeal of McCarran/Ferguson? It seemed to be the first thing that the conference report mentioned and it received more emphasis than some of their tort reform recommendations.

Mr. SWAIN. Well, I do not have the recommendation right in front of me, and I will take your word for it that it was the first thing that they mentioned. I think they put a lot of weight on a number of issues.

I went to 25 or 30 of those State conferences, and I can tell you that the major part of the discussion at those State conferences was on tort reform. And I think that that is a major part of the issue. I am not saying that McCarran/Ferguson is not. I think that is as well, but I do not think that one can simply change McCarran/Ferguson and not try to get some tort reforms. I do not think one can simply have tort reforms and expect that that, either, is the total solution to the issue.

Ms. MEYERS. Thank you.

Thank you, Mr. Chairman.

Chairman LAFALCE. Thank you.

Mr. Mazzoli.

Mr. MAZZOLI. Thank you, Mr. Chairman. I guess this microphone does not work.

Thank you, Mr. Chairman, and Mr. Swain. I have one question and I hope it has not been asked already.

It is on page 4. It is the second full paragraph and it deals with, as you call it, one of the most dramatic findings of the study. It relates to the claims experience of small as compared to large firms. The study shows that in every, and the word every is underlined, industry surveyed smaller firms were significantly less likely to have had a liability claim of $1,000 or more between 1981 and 1986. This finding suggests that whatever the cause for the high cost and scarcity of liability insurance, it does not appear to be the claims experience of small business.

And I would ask you—does this mean that the insurance companies are ripping small businesses off because they cannot apparently assign these escalating rates to claims experience? Then what is your preliminary judgment that they are assigning this escalation to?

Mr. SWAIN. Well, I think they are assigning the escalation to the overall claims experience, and our point simply is that we do not believe they can accurately assign an escalating small business premium to an escalating number of claims from small businesses.

Mr. MAZZOLI. Well, then let me ask you the second question.

Are you aware, or maybe the other witnesses today—can insurance rates be so discreetly applied that you can select out large employers, large activities from small and charge what the experience would suggest for large and charge what the experience would suggest for small?

Mr. SWAIN. Well, my understanding, and I know there are much better experts than I, routinely large companies are experience rated, and they are in fact selected out many times at their own request where they have good experience, obviously, and their claims are analyzed, and they can shop around and obtain as favorable rates as they can.

I do not know the answer to the other part of your question which is whether it is possible, given the way the industry keeps its statistics, to have a more specific pool of small business claims.

Obviously, from an underwriting standpoint, I can understand that it does not make too much sense to take a business that has five employees and write that policy simply on that business' claims record. I can understand why there has to be some pooling.

But as to how large those pools could be or whether it could be more discreet, I really do not have the information. We can certainly look into that and try and get some further information to the committee. I think that is a key issue.

Mr. MAZZOLI. You are satisfied at this time with the preliminary finding though, and you would stand behind it to suggest that whatever the cause for the high cost and scarcity of liability insurance, it does not appear to be the claims experience of small business?

Mr. SWAIN. From what I know, I would stand behind that statement, yes, sir.

Mr. MAZZOLI. Thank you very much.

Thank you, Mr. Chairman.

Chairman LAFALCE. You understand that it is a rather large statement you are making, Mr. Swain. You are saying that the huge increases in premiums being experienced by the small business community of America do not seem to be based upon the claims experience of the small business experience of America.

Now that is not a modest statement. That is a very important statement. I suspect it is very true. I think I probably would agree with that statement. But I just want to make sure that you understand the import of that.

Mr. SWAIN. We wrote the statement very carefully, Mr. Chairman, and I stand by it.

Chairman LAFALCE. That would tend to suggest that those individuals who claim that a litigation explosion has been the cause of the liability insurance crisis are incorrect, at least with respect to the small business community; is that correct?

Mr. SWAIN. With your last statement, yes.

Chairman LAFALCE. Yes.

Mr. SWAIN. At least with respect to the small business community.

Chairman LaFalce. All right. So your position as Chief Counsel for Advocacy of the Small Business Administration is, at least with respect to the small business community of America, that the claim that a litigation explosion is a major factor in having brought about this liability insurance crisis is incorrect.

Mr. Swain. I would not go that far, Mr. Chairman.

Chairman LaFalce. Oh, I thought you just did.

Mr. Swain. My position—my statement is that with regard to the small business community, carriers are not now using experience rating, at least from our evidence, to any great degree.

Now whether there are statistical reasons for that, I do not know but——

Chairman LaFalce. Well, you are saying though——

Mr. Swain [continuing]. But to the extent that there is a litigation——

Chairman LaFalce. That they are experiencing these great problems and they do not seem to have had, on the basis of the survey that you are using as your basis for testifying, any significant liability problem whatsoever.

Mr. Swain. There does not seem to be a litigation explosion caused by small firms.

Chairman LaFalce. All right, fine.

Mr. Swain. I am not saying that there is not a litigation explosion, and I am not saying that that——

Chairman LaFalce. I understand. That's what I said.

Mr. Swain [continuing]. Litigation explosion is not very extensive.

Chairman LaFalce. With respect to the small business community, there does not seem to be any litigation explosion which could be deemed to be a major cause of the liability insurance crisis for them.

Mr. Swain. On the basis of the study that we have done; yes.

Chairman LaFalce. All right, fine.

For those who immediately want to jump to solutions, you have a problem. You have to have a nexus between the problem and the solution. So many individuals want to forget about establishing a nexus between a problem and a solution, and they will go to a solution and all of a sudden find out that there is no nexus whatsoever between the solution and the problem. And that is why we want some facts.

Mr. Swain. I have done my best to provide them, Mr. Chairman.

Chairman LaFalce. I am not criticizing you, Mr. Swain. I am talking to those individuals who want us to come up with a solution and legislate it without examining the problem first.

Mr. Swain. I would state quite clearly that just because we cannot find the specific connection that you alluded to does not suggest——

Chairman LaFalce. Ah, it does not suggest that it does not exist.

Mr. Swain. That is right. That does not suggest that it does not exist, nor does it suggest that we should reject all those solutions.

Chairman LaFalce. No; not at all. But it does not suggest that we should embrace them, does it?

Mr. Swain. I think that it suggests that we should look carefully at them, and I would be happy to——

Chairman LaFalce. I think logic would dictate that we try to find out just what this problem is all about first. At least, that is how this committee is going to be proceeding.

Let us look at some of the survey though. I do not know exactly what questions were asked, and when we get the final report, I understand we only have the preliminary now, and I appreciate that. But I am a little curious as to what question was asked.

We have various tables. Your first table is the percentage of businesses and size-type categories who reported that the responses to insurance deficiencies had a great impact on their profitability or ability to deliver services.

This is table 1, page 10 and I assume, therefore, the question was, "Do your insurance premiums have great impact on your profitability or your ability to deliver services?" I assume that that was the question that was asked?

Mr. Swain. I assume so, but I will certainly check. I do not have——

Chairman LaFalce. Well, if it is so, it would be difficult for me to think that most businesses would not say yes, automatically, to that. I do not know how relevant that type of a question would be.

Mr. Swain. Most of them did not say yes. Anywhere from a fourth to a third said yes.

Chairman LaFalce. Maybe I should say there would be a much greater likelihood to say yes. In other words, I just do not know how valuable a question of that nature is.

Mr. Swain. It is valuable to the extent that the difference in answering between firms of various sizes and between firms in various industries shows us where the problem is felt to be more acute. It may not be valuable in the absolute sense of the word, but in a comparative sense, it is quite probative.

Chairman LaFalce. Mr. Mazzoli was quite interested, and I think very appropriately so, in your distinction between the experience of small firms and the experience of large firms. We always have a problem of definition.

And on table 2, are you defining small firms as those under 50 and large firms as those over 50?

Mr. Swain. Those were the size breaks that the contractor did as an analysis; yes, sir.

Chairman LaFalce. OK, but, you know, a good many people would call a small firm one with 50, 75, or 100 employees, and most of the trade associations, who believe that they represent small businesses by and large, would be representing businesses that might have more than 50 employees.

And so, they might come in and talk about their small business experience, and you are coming in and making a distinction between a small business and a big business. And the survey has used "under 50" and "over 50" as the breakdown, correct?

Mr. Swain. Yes, sir.

Chairman LaFalce. All right. I just want us to understand that when we are talking with trade associations and when we are using your survey, we might be comparing apples and oranges. And I really view a firm of 50 or 100, more often than not, or even 200, as a small business. As a matter of fact, for virtually every single small business program that exists would not such a firm be considered a small business?

Mr. **Swain**. I do not disagree for a minute, Mr. Chairman.

Chairman **LaFalce**. OK. Then the answer is yes. I just am saying that we have to be very careful in our use of words and the conclusions we draw from those words. Because if we are going to be talking about a big difference between large businesses and small businesses and the cutoff is 50 employees, and other people are going to be coming and talking about the problems that their small businesses are having, and their average size is 200, we have great difficulty in communicating because we are using different definitions for the same words.

Mr. **Swain**. The definition that was used was principally a matter of statistics. That the size sample, had it been 10,000 firms, we might have been able to have more size breaks. But since we only had 1,000 firms in our sample, that——

Chairman **LaFalce**. This is not a criticism. Do not take it as a criticism.

Mr. **Swain**. I am trying to explain why we used that cutoff and I am not standing here saying that the only definition of a small firm is less than 50 employees.

Chairman **LaFalce**. I use this not as a criticism; I use it as a caveat. I have been through this for over a decade, and if I am aware of anything, it is the importance of precision in the use of words.

When we use the word "loss" for example, it can mean a dozen different things. And so we had better define that word "loss". And the same with "profit," and the same with a "claim paid," or a "claim incurred," or whatever. We have to define our terms.

Let me ask you this. Most individuals who are serious students of this cyclical liability insurance crisis believe that the primary reason for the precipitous increase in premiums has been due to the cash-flow underwriting practices of the insurance industry themselves. Do you have any tentative judgment on that?

Mr. **Swain**. I would generally share that view.

Chairman **LaFalce**. All right. Now assume that this is correct. This would mean that insurance companies were charging lower premiums than they should have charged in the period immediately prior to the precipitous increases; is that correct?

Mr. **Swain**. Well, I am not smart enough to say whether it is correct, but I do not—I am simply saying that——

Chairman **LaFalce**. Well, is that not almost a definition of a cash-flow underwriting practice?

Mr. **Swain**. I would agree, in general, that the rates apparently, in the early 1980's were lower than they should have been to build up the necessary reserves.

Chairman **LaFalce**. What I am leading to is this. Does your study take into consideration the percentage of gross sales or gross revenues attributed to the cost of insurance, circa 1978, 1979, 1980, 1981, 1982, and 1983, and then in the crisis years of 1984, 1985, and 1986, so that we might see if there has been any change in the overall percentage of a business total costs?

In other words, is the precipitous increase something that hurts, but is not out-of-line with historical percentage insurance cost of business? I do not know the answer to that. I am curious about it though.

Mr. SWAIN. We do not have information of a time panel nature except on the issue of claims where the question was asked if there were claims in excess of $1,000 over the past 5 years.

Chairman LAFALCE. All right.

Mr. SWAIN. But we did not ask questions about profitability for 5 years or premiums for 5 years. We simply asked about current premium and current profitability.

Chairman LAFALCE. Those are the only questions I have. Any other questions, or should we go on to the other panel?

Yes; Mr. Rhodes.

Mr. RHODES. Mr. Chairman, thank you.

More of an observation than a question. From listening to your questions and your statements, I have reached the conclusion that I think you and I probably share the same rather healthy skepticism about the claims as to the cause and effect of the so-called liability crisis and what the solutions ought to be. And like you, I have been searching for that nexus for quite some time, and I share your feeling about the value of this survey which is before us, which basically reinforces the gut feeling that practically everyone of us has, but does not lead us to a conclusion, and certainly does not lead us to a solution.

And my rhetorical question is, how are we going to gather the information that is necessary for us to establish whether or not there is that nexus, because that information resides——

Chairman LAFALCE. I will put you down as a cosponsor of the bill we will be introducing in about 2 weeks.

Mr. RHODES. Well, sir. Mr. Chairman, let me hasten to say that while I have had these questions in my mind for quite some time and have worked on them in a prior capacity, I have not yet come to the conclusion that the solution lies with the Federal Government.

So if cosponsoring your bills puts me in that position, I am not sure I want to be there, but all I——

Chairman LAFALCE. Not necessarily.

Mr. RHODES [continuing]. All I want to observe is that the information we need resides in the records of those who are insisting the most that we must change our tort system, and that is the insurance companies. And my observation is that those who want us to change our system of civil justice should be prepared to come forward and justify empirically why we should do so. And in my experience at least, they have not been yet willing to do so.

Chairman LAFALCE. All right. Well, thank you, Mr. Rhodes. I am sure we are going to find many areas of agreement, more so agreement than disagreement on this.

The last great crisis which was circa 1976, 1977, and 1978, really the only good data that came about, at least as far as I was concerned, was due in small part to data that came about in response to questionnaires that the Small Business Subcommittee that I chaired at that time had sent out to the major insurers of America. But primarily the best data was from the insurance industry itself through their Insurance Services Offices, ISO, when they conducted a closed claims study.

We have not had a closed claims study since that time. Really, we need another major closed claims study. There is absolutely no question about it. Until such time as we get a major closed claims study, properly constructed, we are going to be working at a great disadvantage.

Mr. Swain, thank you very much. You and I really should get together just to talk about these and a whole range of other issues so that we can start working more in concert and cooperation, because I would like to do that very much.

Mr. Swain. And, Mr. Chairman, if I could state for the record, I was not aware that there might be an interest in having me sit with the rest of the panel. And so, therefore, I do have a time commitment.

Chairman LaFalce. I understand.

Mr. Swain. But I appreciate the opportunity to do so at some other time and answer any questions.

Chairman LaFalce. Thank you very much.

We will now bring our other witnesses to the table in panel form: Mr. Raymond Hayes, representing the National Association of Insurance Brokers, Mr. Richard Reinhardt, representing the NFIB, and Ms. Barbara Balter on behalf of the National Association of Women Business Owners.

We will take you in the order that you are sitting, starting with Mr. Hayes.

TESTIMONY OF RAYMOND L. HAYES, PRESIDENT, THE NATIONAL ASSOCIATION OF INSURANCE BROKERS, INC., AND SENIOR VICE PRESIDENT, ROLLINS BURDICK HUNTER CO.

Mr. Hayes. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, I, too, wish to submit my report. I will detail or highlight a few of the points in it.

Chairman LaFalce. Without objection, we will put the entire testimony of all of the panelists in the record and you may proceed to summarize your remarks. So ordered.

Mr. Hayes. Thank you.

I am testifying before you today as president of the National Association of Insurance Brokers. I am also a senior vice president of Rollins Burdick Hunter Co., which is about the seventh largest insurance broker in the country.

The clients of NAIB members operate in every State of the Union, as well as internationally. Some of our clients range from single-person employers to multiperson employers. Their categories of commerce range from commercial, professional, and service industries to not-for-profit organizations and cover, truly, a wide gamut of our U.S. economy.

I mention all this merely to emphasize the fact that as brokers we must understand the insurance marketplace because, daily, we labor to find all those clients available and affordable insurance programs.

In testimony before the Senate Small Business Committee last February, NAIB, our association, reported that there was a serious capacity problem. However, today I can report that we have seen strong signs of improvement in recent days with respect to the capacity problem.

In preparation for this appearance today, I have talked with NAIB members, small and large brokerage firms around the country. And without exception, their experiences in seeking coverage for their clients mirrors my own. This picture is brighter than it was a year ago.

Capacity has increased; premiums are leveling off, dropping slightly in some cases. But problems still remain.

There are specific coverages that are difficult to find. Insurance for chemical, pharmaceutical manufacturers, day-care centers, and contractors is still limited, as is the professional malpractice coverage for architects, lawyers, doctors, accountants, and even ourselves, insurance brokers. Directors and officers liability is limited. Excess umbrella liability is difficult. Products liability, environmental impairment insurance, pollution coverage, remain unavailable in the traditional insurance marketplace.

Overall, the availability and affordability picture is not yet as bright for small- and medium-business as it is for big business.

New York's recent decision to form a Market Assistance Program to provide small business with liability coverage is evidence that the crisis is not over for some.

I believe it is important to note here that there is a market realignment underway that affects insurance options for small business. Some major insurance carriers have made corporate decisions to leave the small business market. They have done this either by declining to underwrite such business or setting minimum premium levels for their business owners' policy that effectively eliminates the small business client.

While availability has eased and small business and so-called Main Street businesses can find coverage today, affordability remains a problem.

Marketplace alternatives are more appropriate, I submit, for the larger client than the Main Street business.

But it must be mentioned that marketplace alternatives have been developed and will continue to be developed, because in recent years there has been a trend toward the use of a variety of self-insurance mechanisms as insurance buyers seek greater control over their costs and alternatives to a marketplace that just does not meet their needs.

This reflects a new sophistication in the use of risk management tools including careful analysis of risk exposure and action to minimize that exposure. Simply assuming higher deductibles or lower amounts of coverage are forms of self-insurance. In fact, they are forms that all of us in this room practice on a regular basis. The analogy I would use here is in the purchase of our automobile or our homeowners insurance. We do look at the deductible. We think about cost if we purchase $100 deductible, the premium will be $250. Whereas, if we were to purchase a $500 deductible, the premium would be $100. Each and every one of us then asks ourselves the risk management question: Is $400 worth of insurance suitable for a $150 premium? And most of us would opt for the higher deductible.

Some marketplace relief is available for the hard to place coverages by using alternatives such as captive insurers or the risk retention groups.

Risk retention groups, again, are an alternate risk funding mechanism which responds to a need that is not satisfied by the traditional marketplace. And today, thanks to the Risk Retention Amendments of 1986, groups can be formed to provide liability coverage to members who share similar risk exposure.

During the 99th Congress, NAIB actively lobbied for an expanded risk retention law, and we commend the Congress for passing this legislation to give insurance buyers another option for meeting their insurance needs. I believe we will see more use of this mechanism in the future to provide coverage when the traditional marketplace does not respond.

I also think it is important to note that forming risk retention groups, as well as captives, is an extremely costly and lengthy process that requires careful analysis of the risk and, most importantly, adequate capitalization. The range of risk management options for small businesses outside traditional insurance is limited because forming captives and group retention pools may be too expensive and too difficult to administer for a smaller firm.

The most important part of my statement deals with the insurance cycle. The property casualty insurance market, like many industries, is cyclical. In recent years the cycles have grown longer and deeper with product price swings that vary greatly and produce conditions both favorable and unfavorable to insurance buyers.

Skyrocketing rates are excessive and discriminatory. Plummeting rates are inadequate and discriminatory. Both conditions result in anger, confusion, and frustration on the part of the insurance consumer. Equally important and devastating is that the plummeting rates also contribute greatly to the insolvency of the insurance underwriters.

In 1985, the cycle turned with a vengeance. Underwriters sought to rebuild depleted reserves by refusing to cover certain risks altogether and raising premiums substantially. The combination of falling interest rates from record double-digit levels and underwriters' fear of increasingly costly liability claims were major factors in the market's swift change.

Today, insurers are reporting record consolidated net income after taxes totaling $12.7 billion in 1986, including $6.5 billion of realized capital gains, $5.6 billion of operating income and $0.6 billion of Federal income tax credits. The industry had a pretax operating income of $5.6 billion in 1986, and, ironically, this compares with the pretax operating loss in 1985 of $5.6 billion. Nonetheless, the industry reports pretax underwriting losses of $15.8 billion in 1986, compared to $25 billion in 1985.

Given the events of the past 18 months and the inability of many businesses, large and small, to find affordable coverage at levels appropriate for their risk exposure, it is not surprising that Congress has undertaken a review of the insurance business and how it operates. Many policymakers are asking what can be done to flatten the insurance cycle and limit the economic displacement that occurs when the market turns hard.

Much attention has been focused on the McCarran/Ferguson Act's exemption of the business of insurance from the Nation's antitrust laws. While we affirm our support of State regulation of insurance, NAIB's directors believe that review of McCarran/Ferguson is a valid public policy issue.

We caution, however, that congressional review should proceed deliberately with careful attention, given the impact any change in McCarran/Ferguson might have on the insurance marketplace and insurance buyers.

In all candor, I doubt the marketplace would have reacted any differently in the last cycle whether or not McCarran/Ferguson was the law of the land. It must be remembered that insurance is a commodity subject to the normal economic fluctuations. When capacity, that is, capital, is plentiful, consumers benefit from the low premiums and ample coverage. When capacity is down, the cost for our buyers escalates.

We feel compelled to note that consumers were happy to benefit from low insurance costs, which we can attribute to a variety of truly complex factors, and key among them were the high interest rates of the times. When insurers' return on investment is high, those earnings should be reflected in lower premiums. But we also think it is appropriate for consumers to view their insurance costs over an entire cycle. In other words, we do feel that we should look at the total picture as opposed to the snapshot comprising a part of the total picture.

That said, we are still faced with the practical question of how to limit the dislocation caused by major swings in the insurance cycle. There are no easy answers, because we believe that economics dictate that insurance will continue to be a cyclical industry.

Two things, however, seem clear. First, underwriters must exercise greater control over their underwriting practices and resist the frenzied competition for market share that was witnessed in the early 1980's. Stricter adherence to valid underwriting principles by companies in the long run will benefit the consumer as well as the marketplace.

Second, we need more careful monitoring of insurance companies. Competition that leads underwriters to the edge or over the precipice of insolvency should not be tolerated by State regulators. States must provide greater resources to their insurance departments for solvency regulation. States should also provide better solvency information to consumers and their representatives so that better and more informed decisions can be made when the consumer selects an insurer.

Thank you, Mr. Chairman.

[Mr. Hayes' prepared statement, with attachments, follows:]

PREPARED STATEMENT OF RAYMOND L. HAYES, PRESIDENT, THE NATIONAL ASSOCIATION OF INSURANCE BROKERS, INC., AND SENIOR VICE PRESIDENT, ROLLINS BURDICK HUNTER CO.

Mr. Chairman and members of the committee, thank you for the invitation to appear before you today.

My name is Ray Hayes and I am president of the National Association of Insurance Brokers, on whose behalf I am testifying today. I am also senior vice president of Rollins Burdick Hunter Co., one of our country's largest insurance brokerage firms. NAIB members include large international brokerage companies as well as regional and local firms.

Clients of NAIB members operate in every state of the United States and internationally. Some employ a single person, others employ thousands. Our clients operate in every category of industrial, commercial, professional, service and not-for-profit enterprise. We represent them individually in the insurance marketplace, and we also work with many of their industry, trade and professional associations. We place insurance for our clients with hundreds of insurance companies, and we also provide a wide range of risk management services, including self-insurance mechanisms.

I mention all this to emphasize the fact that brokers must understand the insurance marketplace because we labor to find our clients available and affordable insurance products everyday.

In testimony before the Senate Small Business Committee last February, NAIB reported that there was a serious capacity problem. I am pleased to report to you today that insurance capacity shows strong signs of improvement in recent months.

In preparation for my appearance today, I talked with NAIB members with small and large brokerage firms around the country. Without exception, their experiences in seeking coverage for their clients mirrors my own. The picture is much brighter than in 1986.

Capacity has increased; premiums are leveling off and even dropping slightly in some cases. Nonetheless, problems remain.

Market Overview and Problems:

During the height of the liability insurance crisis, some lines of insurance were unavailable or unaffordable. Property coverage was no exception, though placing property insurance for our clients was not as difficult as finding liability coverage. Today there is adequate property insurance capacity, except for earthquake coverage, and insurance companies are actively seeking business.

There is one major difference to be noted when today's property market is compared to the soft market of the early '80s. Companies are underwriting more carefully. Insurers are asking our clients to spend a great deal of money on physical improvements to reduce their risk exposure before they are insured. While this initially can be a financial burden, limiting risk exposure also produces long-term benefits for the insured through fewer losses and a better premium rate.

There are still some property risks -- such as highly volatile oil or chemical risks -- that are difficult to place. Overall, the property market today can be fairly characterized as reasonable given the risk.

Significant changes can also be seen in the general liability market. Capacity has opened up; premiums are leveling off or increasing only slightly. In some instances, primarily on select large accounts, we are seeing notable improvements such as a doubling of coverage limits at last year's premium rate or premium cuts of 30-to-50 percent.

There are coverages that remain difficult to find. Insurance for chemical and pharmaceutical manufacturers is still limited as is professional malpractice insurance for architects, lawyers, doctors, accountants and insurance brokers. Directors and officers liability insurance is still limited in many instances. So is excess and umbrella liability coverage and products liability. Environmental impairment insurance -- pollution coverage -- also remains unavailable in the traditional insurance marketplace.

Coverage for Small Business:

Overall, the availability and affordability picture is not yet as bright for small and medium business as it is for big business. While we see smaller premium reductions for small accounts than large ones, insurers are more willing to underwrite small risks, and some are actively seeking small accounts.

New York's recent decision to form a MAP (Market Assistance Program) to provide small business with liability coverage is evidence that the crisis is not over for some.

I believe it is important to note that there is a market realignment underway that affects insurance options for small business. Some major insurance carriers have made corporate decisions to leave the small business market. They have done this by either declining to underwrite such business or setting minimum premium levels for their business owners' policy that effectively eliminates the small business client.

Other major insurers have made the opposite decision and are abandoning large accounts in favor of small ones. Among those seeking to expand their small accounts business are major direct writers. Many direct writers -- insurance companies that deal directly with the consumer rather than through a broker or independent agent -- are designing business operating policies that provide good coverage for small business.

I must say, however, that while direct writers have competitively earned a place in the small business market, a small business with special or complex risk exposures has a continuing need for the skills of a broker or agent to help design appropriate coverage to be well represented in the insurance marketplace.

While availability has eased for small business and so-called Main Street businesses can find coverage today, affordability is still a problem.

Marketplace Alternatives

In recent years there has been a trend toward the use of a variety of self-insurance mechanisms as insurance buyers seek greater control over their insurance costs and alternatives to a marketplace that does not meet their needs. This reflects a new sophistication in the use of risk management tools, including careful analysis of risk exposure and action to minimize that exposure.

Simply assuming higher deductibles or lower amounts of coverage are forms of self-insurance, because the insurance buyer is willing to accept more risk. In a sound self-insurance program, the self-insurer generally purchases excess insurance that will pay losses above a certain level that reflects the size of the loss an insured can absorb without creating financial problems.

While today's excess market is better than a year ago, availability remains limited with costs high. Large businesses can afford to go off-shore and use ACE or XL (new markets created in response to the hard market). But because of cost and coverage amounts, these mechanisms are no help to small and medium-size risks.

Some marketplace relief is available for hard-to-place coverages by using alternatives such as captive insurance companies and risk retention groups. A captive insurer is an insurance company that is wholly owned by a noninsurance organization, generally a large company or a group of companies in the same business. Its primary purpose is to insure or reinsure the risks of the parent organization, though some also cover the risks of nonrelated parties.

Risk retention groups are a form of captive insurance, and today, thanks to the Risk Retention Amendments of 1986, groups can be formed to provide liability coverage to members who share a similar risk exposure.

During the 99th Congress, NAIB actively lobbied for an expanded risk retention law, and I commend the Congress for passing this legislation to give insurance buyers another option for meeting their insurance needs. I believe we will see more use of this mechanism in the future to provide coverage when the traditional marketplace is difficult.

I also think it is important to note that forming risk retention groups and captives is a costly and lengthy process that requires careful analysis of risk as well as adequate capitalization. The range of risk management options for small businesses outside traditional insurance is limited because forming captives and group insurance pools may be too expensive and difficult to administer for small firms.

Insurance Cycle

The property-casualty insurance market, like many industries, is cyclical. In recent years the cycles have grown longer and deeper with product price swings that vary greatly and produce conditions both favorable and unfavorable to insurance buyers.

In 1985, the cycle turned with a vengeance. Underwriters sought to rebuild depleted reserves by refusing to cover certain risks altogether and raising premium rates substantially. The combination of falling interest rates from record double-digit levels and underwriters' fear of increasingly costly liability claims were major factors in the market's swift change.

Today insurers are reporting record consolidated net income after taxes totaling $12.7 billion in 1986, including $6.5 billion of realized capital gains, $5.6 billion of operating income and $0.6 billion of federal income tax credits. The industry had a pretax operating income of $5.6 billion in 1986, compared with a pretax operating loss in 1985 of $5.6 billion. Nonetheless, the industry reports pretax underwriting losses of $15.8 billion in 1986 (compared to $25 billion in 1985).

Given the events of the past 18 months and the inability of many businesses, large and small, to find affordable coverage at levels appropriate for their risk exposure, it is not surprising that Congress has undertaken a review of the insurance business and how it operates. Many policymakers are asking what can be done to "flatten the insurance cycle" and limit the economic displacement that occurs when the market turns hard.

Much attention has been focused on the McCarran-Ferguson Act's exemption of the business of insurance from the nation's antitrust laws. While affirming their support of state regulation of insurance, NAIB's directors believe that review of McCarran-Ferguson is a valid public policy issue.

We caution, however, that Congressional review should proceed deliberately with careful attention given to the impact any change in McCarran-Ferguson might have on the insurance marketplace and insurance buyers. (Please see attached NAIB policy position.)

In all candor, I doubt that the marketplace would have reacted any differently in the last cycle whether or not McCarran-Ferguson was the law of the land. It must be remembered that insurance is a commodity subject to the normal economic fluctuations. When capacity (capital) is plentiful, consumers benefit from low premiums and ample coverage. When capacity is down, costs for buyers escalate.

I feel compelled to note that consumers were happy to benefit from low insurance costs, which we can attribute to a variety of complex factors, and key among them was high interest rates. When insurers' return on investment is high, those earnings should be reflected in lower premiums. But I also think it is appropriate for consumers to view their insurance costs over an entire cycle.

That said, we are still faced with the practical question of how to limit the dislocation caused by major swings in the insurance cycle. There are no easy answers, because I believe economics dictate that insurance will continue to be a cyclical industry.

Two things seem clear. First, underwriters must exercise greater control over their underwriting practices and resist the frenzied competition for market share that we witnessed in the early '80s. I believe stricter adherence to valid underwriting principles by companies will benefit both consumers and the marketplace.

Second, we need more careful financial monitoring of insurance companies. Competition that leads underwriters to the edge of or over the precipice of insolvency should not be tolerated by state regulators. States must provide greater resources to their insurance departments for solvency regulation. States should also provide better solvency information so consumers and their representatives can make informed decisions when selecting an insurer.

I would be happy to answer your questions.

NATIONAL ASSOCIATION OF INSURANCE BROKERS
1401 New York Avenue, N.W. • Suite 720 • Washington, D.C. 20005 • Telephone (202) 628-6700

NAIB Policy Position on the Review of the McCarran-Ferguson Act

In 1945, with passage of the McCarran-Ferguson Act, Congress determined that insurance is interstate commerce but granted the industry an exemption from federal antitrust scrutiny. The Congress also affirmed that regulation of the industry is the responsibility of state governments. The National Association of Insurance Brokers continues to support this principle of state regulation of insurance.

The recent liability insurance crisis has focused Congressional attention on the McCarran-Ferguson Act and the effectiveness of the state regulatory system.

The National Association of Insurance Brokers recognizes that the liability crisis has generated widespread calls for a review of the exemption of insurance companies from federal antitrust laws to determine if such exemptions continue to serve the public interest. NAIB believes this is a valid public policy issue and that such a review should proceed deliberately. Careful attention should be given to the impact any change in the McCarran-Ferguson Act might have on the insurance marketplace and insurance buyers.

Commercial insurance brokers represent insurance buyers and are experts in the insurance marketplace and risk management services. Members of NAIB stand ready to assist policymakers as they consider modification of the McCarran-Ferguson Act and the insurance regulatory system. Our appropriate role is to serve as an information resource and to help evaluate the impact any proposed changes may have on the marketplace and on our clients.

Adopted by the NAIB Board of Directors
in Washington, March 5, 1987.

Chairman LAFALCE. I thank you very much, Mr. Hayes, for an excellent statement. I think everybody is aware of it, but in case everybody is not aware, the insurance broker, if anyone, can purport to represent the consumer of America; the insurance broker is the individual as opposed to the insurance industry, the insurance company, the insurance agent, et cetera. And I think that your statement reflects that concern for the consumer. I think it is a very balanced statement and one in which I would find myself in general accord.

I understand, Ms. Balter, you prefer to go last.

Ms. BALTER. Whatever is convenient for you.

Chairman LAFALCE. All right. Well, we will take you right now then.

TESTIMONY OF BARBARA G. BALTER, PRESIDENT, ROBERT B. BALTER CO., ON BEHALF OF NATIONAL ASSOCIATION OF WOMEN BUSINESS OWNERS

Ms. BALTER. Thank you, Chairman LaFalce, and members of the House Small Business Committee.

My name is Barbara Balter. I am the president of the Robert B. Balter Co., a geotechnical engineering firm I co-founded in 1963. As an elected delegate to the 1986 White House Conference on Small Business, I chaired the Liability Insurance Committee for the State of Maryland, wrote the Maryland position paper and went on to write the final national recommendations which were adopted unanimously by the attendees at the concluding liability insurance session——

Chairman LAFALCE. Ms. Balter, I wonder if you could try to bring the microphone a bit closer.

Ms. BALTER. I need a booster seat, I think.

Chairman LAFALCE. Thank you.

Ms. BALTER [continuing]. Of the White House Conference. It was voted the No. 1 issue to come out of that conference.

For the past 6 months, I have been serving as co-chair of the Elected Maryland Small Business Advocates. At the Maryland Small Business Conference last November, business owners chose the liability insurance issue as their No. 1 concern indicating that it is still their major problem.

I serve as a liability insurance point person for the National Association of Women Business Owners and for the National Association of Women Business Owners/Baltimore Region, whose president I will become in May.

Just how important is small business to our economy? Are you aware that the small business sector provides jobs for approximately 60 percent of our work force? That it created almost 70 percent of the new jobs our economy generated last year? That, according to Gov. Hughes, 97 percent of all businesses in the State of Maryland are classified as small business? Can we imagine how severe the economic impact would be were small business people discouraged from starting new ventures or expanding their existing ones?

We have become a dynamic, forceful, national economic treasure. Despite all this, many small businesses have closed, and many are vulnerable because of the unpredictability of the liability insurance industry.

This crisis, at best, creates inflationary pressures as the ever-increasing cost of premiums is passed through to the consumer. At worst, it forces businesses to close when cost escalation is no longer possible or insurance is no longer available. And in between, stress levels mount as businesses operate without insurance, drop product lines or face bankruptcy in the event of a suit.

Is the crisis over, as the insurance industry claims? Let me share a true story with you.

A small engineering company, with great expertise in its specialty, using the latest state-of-the-art and maintaining a top-notch reputation was able to obtain a professional liability insurance policy of $1 million, a $25,000 deductible and, for an additional one-time-only premium, first day coverage. The total premium was $30,000. In 1984, premiums were $34,000. In 1985, although the insurance had been in force for more than a dozen years without one claim ever having been paid, nonrenewal notice was given by the insurer just days before the policy expired, claiming that the risk was too great.

After a great deal of negotiating, a $1 million policy was offered at a premium of $66,000, but no longer included first-day coverage. While analyzing the impact this sudden change would have on this company, notification was received that the offer had been revised, the policy had been cut to half a million dollars, with no first day coverage, at a premium of $89,000. In a 2-week period of time, the limit was cut in half, protection was lost on approximately 9,000 previously covered projects, and premiums escalated from $34,000 to almost $90,000 a year!

Is it better now? Within the last month, a tentative quote was received for a $1 million policy, $50,000 deductible, no first-day coverage and several new exclusions at a premium of $171,600. Reinstating first-day coverage would cost my company an additional 50 percent a year. That's almost $260,000 for a $1 million policy. After the insured pays the deductible, it would cost this small company, that is, my small company, $310,000 before the first dollar of insurance would become available.

Since some may consider that my particular business is unusual, let us look at a one-story building occupied by a travel agency, whose premium was raised, in 1 year, from $536 to $5,639, an increase of 1,100 percent. That happened 38 days ago. These are not isolated examples. I can provide this committee with hundreds of similar, current cases. The insurance crisis is far from over.

For the average person, the market has begun to stabilize in that there are no quantum leaps in cost, and the insurers are beginning to write new insurance. But for professionals, manufacturers, and many businesses, adequate insurance is still unavailable, unaffordable, or ineffective.

The problem continues. During the 6 months I spent in research preparing position papers, it became clear that the experts, pointing fingers of blame at each other, were right.

The insurance industry blames the U.S. civil justice system for having shifted its focus toward compensating injured persons regardless of whom was at fault in causing the injury, and threatens that there can be no stabilization in the marketplace without tort reform.

The trial lawyers, or plaintiffs' attorneys, shout, "Unfair," wheel out a victim and ask how we can be so uncaring as to not protect the rights of the injured party, or the poor, when the argument touches on contingency fees.

Meanwhile, the National Insurance Consumers Organization suggests that because insurance and reinsurance companies are not subject to antitrust laws, Federal regulation, investigation, or control, and because industry accounting policies allow it, companies are able to distort their profits showing nonexistent losses, skyrocket premiums when there is no actuarial need to do so, and use the weakness of our civil justice system as an excuse for the liability insurance crisis and as a massive weapon to dramatically increase their profits. Wall Street seems to support the earnings portion of NICO's charge.

And the snowballing of suits continues. In 1984, there was a private civil lawsuit for every 15 Americans. From 1977 to 1981, the number of civil lawsuits in State courts grew four times as fast as the population. Between 1978 and 1983, 12 million lawsuits were filed in State courts. I was told there were 27 million filed in 1985 alone, but I could not locate the source material on that so I just eliminated that figure from my report. The average product liability award exceeded $1 million in 1984, and in the decade between 1974 and 1984 the number of liability suits filed in Federal courts expanded by 68 percent. The average verdict in medical malpractice cases now also exceeds $1 million.

More shocking is the cost of all of this. For example, 10 years ago, for each dollar of premium paid, 15 cents went to pay attorneys. In 1986, for each dollar of premiums paid, 76 cents went to pay attorneys' fees. It is time to call a halt.

I was told that each of you received a copy of the report presented to the President entitled, "The White House Conference on Small Business: A Report to the President of the United States."

The recommendations, included for legislative and Presidential action, encompass a four-pronged effort at reform and, if followed as proposed, would redress the problems highlighted by the representatives of the insurance industry, the trial lawyers, the consumers, and the business people. To really be effective it was hoped that the proposed changes would be treated as a whole.

When I started, as a delegate to the White House Conference, doing research on the Maryland paper, the Maryland delegates were of one mind that tort reform was the way to go. But as we got into it and more information was found, it became clear to us that that was not the only issue. The insurance companies must be controlled and regulated better. The McCarran/Ferguson Act has to be revised, or at the least, reviewed. We need an education program to teach people that there is an inherent risk in living, we must assume responsibilities for our actions, and we cannot make a lottery of our legal system.

The four-pronged recommendation that we made, that we felt we must adhere to, was endorsed at the regional meetings that were held and then at the National Conference where it was adopted in its entirety.

However, if I had to spotlight one recommendation in the area of tort reform that would do most to bring about beneficial change, it would be a return to a fault-based standard of liability. Richard K. Willard, an Assistant U.S. Attorney-General, was quoted in Newsweek in February 1986 as saying, "I believe the answer lies in recent legal movements by activist judges and tort lawyers who see no bounds to the ever increasing expansion of tort liability."

Traditionally, tort liability was based on fault. Under the current trend, however, tort law is used to punish those who may have done nothing wrong but who have the resources to pay the damages. Strict liability makes it possible to award damages without any proof of negligence. Joint and several liability is perhaps the thorniest concept. It allows a plaintiff to sue everyone who might share in the responsibility for an accident and if any of the defendants is found to be partially at fault, that defendant may be forced to pay the entire judgment. Originally intended for those who acted in concert, it is now what has become known as the deep pockets doctrine.

For an example a building is designed by a structural engineer and built by a contractor. During construction, a testing laboratory is asked to test some concrete samples to make certain the strength of the concrete meets design specifications. Subsequent to this—perhaps even years later—the building shows evidence of distress. The design may have been faulty, but the firm that designed it has no financial resources and the building contractor is no longer in business. The testing laboratory does have assets and even though their work was proper and their fees may have been as little as $60 for six tests, they could be the deep pockets and end up paying the entire judgment.

The Statue of Justice wears a blindfold and is holding a balance to indicate that our system of justice is fair and evenly dispensed. To be just, we must be fair to the defendant as well as the plaintiff.

My insurance problem led me to the White House Conference where I met hundreds of other delegates similarly concerned. I will not forget one business owner who stood up at our closing issue session and said, "I agree with all of the final recommendations being made, but what can you do that will prevent me from going out of business next week?" Next week is obviously too soon. But I pass that question on to you with the sad realization that with every week that passes, it is already too late for many.

I thank you.

[Ms. Balter's prepared statement, with attachments to testimony follows:]

PREPARED STATEMENT OF BARBARA G. BALTER, PRESIDENT, ROBERT B. BALTER CO., ON BEHALF OF NATIONAL ASSOCIATION OF WOMEN BUSINESS OWNERS

NATIONAL ASSOCIATION OF WOMEN BUSINESS OWNERS
Baltimore Regional Chapter

TESTIMONY PRESENTED

TO

THE HOUSE SMALL BUSINESS COMMITTEE

LIABILITY INSURANCE

BARBARA G. BALTER

APRIL 23, 1987

Thank you, Chairman LaFalce, and members of the House Small Business Committee.

My name is Barbara G. Balter, I am the President of The Robert B. Balter Company, a geotechnical engineering firm I co-founded in 1963. As an elected delegate to the 1986 White House Conference on Small Business, I chaired the Liability Insurance Committee for the State of Maryland, wrote the Maryland position paper and went on to write the final national recommendations which were adopted unanimously by the attendees at the concluding Liability Insurance session of the White House Conference.. It was voted the number one issue to come out of that conference.

For the past 6 months I have been serving as Co-Chair of the Elected Maryland Small Business Advocates. At the Maryland Small Business Conference last November, business owners chose the liability insurance issue as their number one concern indicating that it is still their major problem.

I serve as a Liability Insurance Point-Person for the National Association of Women Business Owners and for the National Association of Women Business Owners/Baltimore Region, whose President I will become in May.

Just how important is small business to our economy? Are you aware that the small business sector provides jobs for approximately 60% of our work force? That it created almost 70%

of the new jobs our economy generated last year? That 97% of all businesses in the state of Maryland are classified as small business? Can we imagine how severe the economic impact would be were small business people discouraged from starting new ventures or expanding their existing ones? We have become a dynamic, forceful, national economic treasure! Despite this, many small businesses have closed, and many are in danger because of the unpredictability of the liability insurance industry. This crisis, at best, creates inflationary pressures as the ever-increasing cost of premiums is passed through to the consumer. At worst, it forces businesses to close when cost escalation is no longer possible or insurance is no longer available. And in between, stress levels mount as businesses operate without insurance, drop product lines or face bankruptcy in the event of a suit.

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Is it better now? Within the last month, a tentative quote was received for a million dollar policy, $50,000 deductible, no first-day coverage and several new exclusions at a premium of $171,600! Reinstating first-day coverage would cost an additional 50% year. That's almost $260,000 for a million dollar policy. After the insured pays the deductible, it would cost this small company $310,000 before the first dollar of insurance would be available!

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And the snowballing of suits continues.

- In 1984 there was a private civil lawsuits for every 15 Americans.
- From 1977-1981 the number of civil lawsuits in state courts grew 4x as fast as the population.
- Twelve million lawsuits were filed in state courts between 1978 and 1983. Twenty-seven million in 1985 alone!
- The average product liability award exceeded $1,000,000 in 1984 and in the decade between 1974 and 1984 the number of liability suits filed in Federal courts expanded by 68%.
- The average verdict in medical malpractice cases also exceeds $1,000,000.

More shocking is the cost of all of this. Ten years ago, for each dollar of premium paid, 15 cents went to pay attorneys. In 1986, for each dollar of premiums paid, 76 cents went to pay attorneys' fees! It is time to call a halt.

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Traditionally, tort liability was based on fault. Under the current trend, however, tort law is used to punish those who may have done nothing wrong but who have the resources to pay the damages. Strict liability makes it possible to award damages without any proof of negligence. Joint and several liability is perhaps the thorniest concept. It allows a plaintiff to sue everyone who might share in the responsibility for an accident and if any of the defendants is found to be partially at fault, that defendant may be forced to pay the entire judgement. Originally intended for those who acted in concert, it is now what has become known as the "deep pockets" doctrine.

An example. A building is designed by a structural engineer and built by a contractor. During construction, a testing laboratory is asked to test some concrete samples to make certain the strength of the concrete meets design specifications. Subsequent to this, -- perhaps even years later, the building shows evidence of distress. The design may have been faulty, but the firm that designed it has no financial resources and the building contractor is no longer in business. The testing laboratory does have assets and, even though their work was proper and their fee may have been $60.00 for 6 tests, they will be the "deep pockets" and end up paying the entire judgement.

The statue of Justice wears a blindfold and is holding a balance to indicate that our system of justice is fair and evenly dispensed. To be just, we must be fair to the defendant as well as to the plaintiff.

My insurance problem led me to the White House Conference where I met hundreds of others similarly concerned. I will not forget one business owner who stood up at our closing issue session and said, "I agree with all of the final recommendations being made, but what can you do that will prevent me from going out of business next week?" "Next week" is obviously too soon. But I pass that question on to you with the sad realization that with every week that passes, it is already too late for many.

Thank you. If you have any questions, I will try to answer them.

Barbara G. Balter

MARYLAND DELEGATION

COMMITTEE ON LIABILITY INSURANCE

Barbara G. Balter, Chair

LIABILITY INSURANCE

A. **Problem:**

The liability insurance crisis is the most serious, far-reaching business issue we face today and will affect us adversely both as individuals and as small business owners as the impact of this problem begins to change the very way we live.

B. **Background:**

Liability and Errors and Omissions insurance premiums have soared in price over the past year and are expected to continue their upward spiral this year as well, despite the fact that coverage, in almost all cases, has dropped to a fraction of what it had been. Ten percent of small business owners can't buy liability insurance at any price and more than half are paying premiums at least 50% higher than last year. In some industries, increases of 500% or more are not uncommon, nor are boycotts of entire categories of professions and industries. The exorbitant cost is causing small businesses to "go bare", to close their doors, to drop product lines, or to face bankruptcy in the event of a suit. Since Dun & Bradstreet Corporation's annual employment forecast predicts that companies with fewer than 100 employees will create two-thirds of the 3,000,000 new jobs the U. S. economy is expected to generate this year, the impact on the level of unemployment could be severe were entrepreneurs discouraged from starting new ventures or expanding their existing small businesses.

The cause of the crisis is a matter of some debate. Critics of the insurance industry claim that the crisis has been created by the industry's efforts to recover huge underwriting losses created by too many years of underpricing its products. Consumer activist, Ralph Nader, has charged the insurers with manufacturing the current crisis in an effort to increase prices, swell profits and achieve massive tort reform. Mr. Nader and the National Insurance Consumer Organization have maintained that the insurance industry's historic pricing record is based on a 10-year cyclical profit pattern that is unnecessary and unjustified. Insurance companies cut prices when interest rates are high, creating high profits, and raise prices when interest rates are low and income drops. But just how far do profits really fall? Because insurance and reinsurance companies are not subject to anti-trust laws or federal regulation or control, and because industry accounting policies allow it, companies are able to distort their profits, dramatically showing losses which do not exist, skyrocket premiums when there is no actuarial need to do so, and use the weaknesses of our civil justice system both as an excuse for the liability insurance crisis and as a massive weapon to dramatically increase their profits.

Another problem contributing to the insurance crisis, Mr. Nader & N.I.C.O. claim, is the failure of the U. S. to regulate the mostly foreign reinsurance companies thus enabling them to dramatically increase reinsurance premiums for the primary insurer, or refuse to reinsure in certain markets. The trial lawyers have also contested the need for tort reform to ease the tight insurance market, and oppose placing restrictions on the peoples' rights to be fully compensated for injuries.

Although the insurance industry admits that its stiff, new underwriting policies are partially in response to its unwise pricing practices in the past, they maintain that a large part is the result of a U. S. civil justice system that has shifted its focus toward compensating injured persons regardless of whom was at fault in causing the injury. And the risk of suit increases.

"Given the litigious nature of American society these days, just about any kind of business, profession or government agency is likely to become a target cf a suit alleging malpractice or negligence resulting in personal injury."[1]

In 1984 there was a private civil lawsuit for every 15 Americans. The personal injury cases with awards exceeding $1,000,000 is now more than 13 times the 1975 total. Twelve million lawsuits were filed in State courts between 1978 and 1983. The average product liability award has increased from $345,000 to more than $1,000,000 in 10 years and the number of product liability suits filed in federal courts alone has tripled since 1960. "The $9.1 billion Americans paid last year in liability insurance premiums was almost 60% higher than the figure as recently as 1983, and roughly equal to the combined budgets of the National Aeronautics and Space Administration and the Central Intelligence Agency."[2] " In 1985, insurance premiums rose by almost $25 billion, more than $100 for every man, woman and child in the U. S."[3] This year's total will show a giant leap.

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[1] Church, George J., "Sorry Your Policy is Cancelled", Time, March 24, 1986.

[2] Ibid., pp. 16-17.

[3] Best's Insurance Management Reports, December 30, 1985.

There are 3 times as many lawyers practicing now as there were in the 50's and it costs 37 times more to run the tort system than it did then. From 1977 to 1981 the number of civil lawsuits in State courts grew 4 times as fast as the population of the U. S. In the decade between 1974 and 1984 the number of product liability suits in Federal courts expanded 680%. The first million dollar verdict did not occur until 1962, but there were 401 in 1984. The average verdict in product liability cases now tops $1,000,000.

Preliminary figures for 1985 indicate that the average verdict in medical malpractice cases also exceeded $1,000,000 for the first time. Chief Justice Warren Burger says the American public "has an almost irrational focus- virtually a mania - on litigation as the way to solve all problems."[4] If this is true, how did we get there and how do we alter this course?

Richard K. Willard, an Assistant U. S. Attorney-General, says about the insurance crisis: "I believe the answer lies in recent legal movements by activist judges and tort lawyers who see no bounds to the ever increasing expansion of tort liability."[5] Traditionally, tort liability was based on fault. Under the current trend, however, tort law is used to punish those who have done nothing wrong but who have the resources to pay the damages.

Evolution in liability law has led to increased jury awards. The amounts assessed by juries to compensate for lost wages and medical payments now make up the smallest part of many liability awards. They are likely to add on larger amounts for uneconomic, unmeasurable criteria as pain and suffering and punitive damages. Juries sometimes find that a person's actual damages amounted to a few thousand dollars yet decide that the business at fault should pay punitive damages in the millions.

Another legal concept being used ever more widely is that of strict liability, which makes possible an award of damages without any proof of negligence. Most states also adopted looser standards of comparative negligence. Even if an accident is partly due to the plaintiff's own negligence, he can successfully sue someone else who also bears some of the blame. Perhaps the thorniest concept is joint and several liability. In actuality, it allows a plaintiff to sue everyone who might share in the responsibility for an

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5. Bacas, Harry, "Liability:Trying Times", Nation's Business, February, 1986.

accident and if any of the defendants is found to be partially at fault, that defendant may be forced to pay the entire judgement! Originally intended for those who acted in concert, it is now what has become known as the "deep pocket" doctrine and is in force in nearly all states.

Since the Maryland Small Business Conference in Baltimore last December, the liability insurance issue has become recognized nationwide as a major issue. Many organizations are getting involved and the media has directed some of its attention to this matter. In spite of the legislation now being proposed on both the State and Federal levels, it is the consensus of the members of this committee that we continue to press for those changes we feel will make a difference in the future availability and affordability of liability insurance. Since it is a truism that one cannot pass laws compelling a company to stay in business, it should not be possible for one industry to have the inordinate power to make decisions that may determine whether or not a business can continue to function. And so we must direct our energy toward those areas that will enable the insurance industry to predict losses so that premiums charged might be reasonable and justifiable to both the insurance industry and the small business people who need to purchase that coverage. A major concern seems to be the extraordinary jury awards in this country. It is given as the reason the reinsurance business has virtually dried up in this country. Lloyds of London stated, as their reason for withdrawing from the U. S. market, that they do not understand the civil justice system in our country and will not underwrite insurance for this market. Without reinsurance firms, like Lloyds, the risks become too great for an insurance company to underwrite alone. We, therefore, feel that some of the possible solutions will have to address tort reform to make the civil justice system more efficient, fairer and much less costly, as well as insurance regulation to make insurance available without wildly fluctuating, cyclical rate changes.

C. Possible Solutions:

Tort Reform:

I. Return to proving negligence. Do away with joint and several liability. If more than one defendant is found negligent and partly responsible for an injury, culpability should be apportioned according to the approximate degree of fault and each defendant's requirement to pay damages should reflect his share of responsibility for the injury

a. Advantages

1. Would help end "frivolous" suits.

2. Would restore credibility to our civil justice system in that the party punished would have to be a guilty party, not just one with "deep pockets".

3. No defendant would have to pay for someone else's negligence.

b. Disadvantages

Difficulty in proving negligence and apportioning blame might preclude injured party from obtaining compensation.

II. Limit pain and suffering awards and eliminate punitive damages except in cases of deliberate fraud, malice or willful and wanton acts. Allow introduction of evidence about other payments a victim may receive. Limit damages for non-economic losses to $200,000. Punitive or exemplary damages awarded shall be paid to the benefit of the people of the State and placed in a specified account, in the general fund, to be used for insurance-related purposes.

a. Advantages

1. Will help establish consistency and fairness in non-economic awards.

2. Will help control the excessive jury awards and enable insurance losses to become more predictable.

b. Disadvantages

Would impact most heavily on seriously injured people with permanent or long-term disabilities.

III. At the request of either party, allow awards exceeding $50,000 to be paid in structured payments running over a period of years and equal to the total award. The jury should be required to itemize the awards for each of the damages. If directed by the plaintiff, the defendant should be required to purchase an annuity to assure payment.

a. Advantages

1. Companies with few resources or assets could purchase an annuity assuring the timely payments of the judgement.

2. Most people do not know how to handle large sums of money and this would guarantee the injured party financial support and care for a long time, often for life.

b. Disadvantages

1. Might cost more to administer.

2. Plaintiff would not have the benefit of the interest that could be accrued.

IV. Limit contingency fees and set a sliding scale for attorney's fees. Develop standards whereby the loser, and his attorney, will be responsible for the winner's legal fees and court costs if suit is unsuccessful and a good-faith settlement was rejected. (Could be waived, if arbitration is chosen.) Tighten our procedures so that attorneys can not repeatedly delay or impede the fair progress of the trial.

a. Advantages

1. Would increase the proportion of the award actually going into the victim's pocket.

2. Would discourage frivolous suits by making it important to the attorney to have a strong basis for suit before litigation.

3. Would reduce substantial legal fees for both the defendant and the plaintiff.

4. Would encourage settlement other than by trial.

b. Disadvantages

1. When a lost case could result in financial penalties, lawyers would be reluctant to participate in any but the strongest cases.

2. Plaintiffs who could not afford the financial risk resulting from a lost case could be prevented from pressing suit.

3. Would impact on defense attorney's earnings. Since their fees are based on a time basis, they usually earn more trying a case then settling it.

V. Claims under $100,000 should be required to go to arbitration.

- a. Advantages
    - 1. Tort litigation is time-consuming and expensive. Arbitration would result in a considerable savings in both, and get more money to the victims with the least delay.
    - 2. It would do much to relieve the crowded court dockets.
- b. Disadvantages
    - 1. Would deny the plaintiff's right to a trial by jury.
    - 2. Might encourage claims in excess of $100,000.

VI. Establish a uniform federal product liability standard and direct responsibilities for product defects, failures and damages to the manufacturer, retailer or consumer. Put sensible restrictions on product liability by returning to personal responsibility for misusing a product or not following manufacturers' directions and warnings. Have a statute of limitations on the expected in-service life of a product and have all imports subject to the same laws as domestic products.

- a. Advantages
    - 1. Uniform standards would enable manufacturers to be in compliance with the laws of every state.
    - 2. It would relieve the manufacturer from the responsibility of being familiar with product liability laws in each of the 50 states.

VII. The current statute of limitations must be amended and clarified to ascertain that suits are brought within a reasonable time and state-of-the-art applied to the date the service was performed, not the current state-of-the-art.

- a. Advantages
    - 1. It would inject a sense of fairness in that records, witnesses, etc. would be available to reconstruct the events leading up to the suit.

2. It would eliminate the unfair burden of making the defendant responsible, ex-posto-facto, for things about which he had no way of knowing.

VIII. Eliminate, or place severe restrictions on class action suits.

a. Advantages

Would reduce the scramble among lawyers for potentially huge fees when there is a disaster involving many people.

b. Disadvantages

Could be more complicated having many attorneys suing individually on behalf of a client.

IX. Include legal defense costs as part of insurance coverage with awards and costs to be cumulative.

a. Advantages

1. Would reduce settlements paid by insurance companies.

2. Might discourage suits when the insured amounts are low.

b. Disadvantages

1. Would not give consistent coverage which would, after one settlement or suit, not enable a business to comply with the insurance requirements of the industry to get work.

2. High legal fees would cut into the balance of dollars available to the injured party.

Insurance Reform

I. Tighten insurance regulations by removing the insurance industry's exemption from anti-trust laws and federal regulations by repealing the McCarran-Ferguson Act of 1945.

a. Advantages

1. Insurance companies would no longer be allowed to share information and engage in collusive premium setting policies that are illegal in any other industry.

2. Prices and coverage would become more competitive.

II. If coverage is unavailable, change the law to allow small businesses to expense dollars not to exceed the cost of an annual insurance premium, if put into a restricted account as an individual reserve fund for self-insurance.

a. Advantages

1. However small this fund may be, it will be more than what would have been available in the event of a claim.

2. This fund could build up over time to afford better protection to a small business...even ensuring predetermined pay-outs in the event of a judgement against the company.

3. Insurance premiums are considered a business expense and are paid with pre-tax dollars. It is reasonable to allow self-insurance set-asides the same pre-tax dollar arrangement.

b. Disadvantages

Many small business will not be able to set aside funds.

III. Set up a federal insurance office to monitor the industry, review state regulations and set standards for state regulators to follow.

a. Advantages

Since only a few states have actuaries working for them, it would be helpful to be able to have state regulators have some expertise in determining loss and recommending an appropriate level of rates for insurance.

b. Disadvantages

Would create another federal office.

IV. Set up new federal insurance program for industries hardest hit by unavailability of insurance.

a. Advantages

1. Small businesses would not be "whipsawed" every time the insurance industry went through another cyclical 10-year pricing crisis.

2. There would be a source for acquiring insurance.

V. Authorize the establishment of joint underwriting associations to issue liability policies written by Government to customers who did not get liability or E.O. insurance.

a. Advantages

1. We would no longer be held captive by foreign reinsurers who pay no taxes, and are not regulated or licensed to do business in this country.

2. This underwriting association would compete with reinsurance firms like Lloyds of London and exert downward pressure on insurance rates.

D. Conclusions:

Although we do not feel that there is one clear answer to this liability insurance crisis, and we feel there may be some merit to the "cyclical" insurance cost phenomenon, we are of the opinion that small businesses cannot continue to survive in an uncertain, unstable climate...especially when we look at the enormous increase in the number of suits and the size of the awards becoming commonplace in our courts today. Even more critical, it has become more common to require liability insurance as a condition for awarding work. Not having insurance available becomes a restraint of trade and interferes with the right to earn a living. Business people must have affordable insurance coverage available for their needs if they expect to stay in business and contribute to the economic vitality of our country.

E. Recommendations:

Many of the suggestions we are making for legislative help in alleviating the insurance crisis have been passed or are currently being considered by Congress or various State governments. Nonetheless, since we have no way of predicting what will pass into law, we are making no assumptions that any changes will be made and are, therefore, reiterating our recommendations.

1. Enact a federal product liability law including uniform standards; responsibility for defects, failures and damages directed to the manufacturer, retailer or consumer, based on fault and including a reasonable statute of limitations on expected in-service life of the product.

2. Establish a strict standard of negligence with each party's liability limited to his share of contributory negligence. Eliminate punitive damages except in cases of deliberate fraud, malice or willful and wanton acts.

3. Enact legislation limiting pain and suffering awards to a maximum of $200,000; introduce sliding scale limits on attorney's fees; penalties for frivolous suits and awards payable in structured payments.

4. Require arbitration for claims under $100,000 as a less costly alternative to litigation.

5. Repeal the McCarran-Ferguson Act of 1945 which exempts insurance companies from federal regulation and anti-trust laws.

6. Amend the tax laws to allow small business to self-insure with before-tax-dollars and have the government provide federal reinsurance programs for the industries and professions insurance companies boycott.

7. Require that actuarial histories be submitted for review in order to determine what the actual costs are for providing casualty insurance prior to increases in premiums. Make it unlawful to cancel policies in the middle of a policy period, or not renew without notice to the insured 90 days prior to the expiration of the policy.

8. Require that foreign insurance companies comply with disclosure laws.

9. Have premiums based on experience records of insured with pooled insurance for those who have high or frequent claims.

10. Establish criteria to assure equity in economic damages so that those who suffer permanent or serious long-term disabilities will be compensated in accordance with a predetermined scale rather than at the whim of a jury or court.

Barbara G. Balter, Chair
Insurance Committee

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Chairman LaFalce. Thank you very much, Ms. Balter, for a very, very fine presentation, which I understand was your maiden voyage before a committee of the Congress.

Ms. Balter. Yes; it is.

Chairman LaFalce. Thank you very much.

Our next witness will be Mr. Richard Reinhardt, president of PII Affiliates on behalf of the NFIB. Mr. Reinhardt.

TESTIMONY OF RICHARD REINHARDT, PRESIDENT, PII AFFILIATES, LTD., ON BEHALF OF NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. Reinhardt. Thank you, Mr. Chairman and committee members. Before I summarize the NFIB testimony, I will give you just a little bit of background so that you can understand what PII Affiliates is and who Dick Reinhardt is.

PII Affiliates is really six small companies that number in employment from 1 to 45, all under that 50 number that we were talking about earlier. The experience of lawsuits is primarily in one of those six companies.

The original business that I purchased in 1975—the material handling distribution company—was sued in 1976 for a lot more money than I paid. And I did not have all of the money I paid, as I borrowed most of it. So that shocked me considerably. And I have been sued a total of six times in the 12 years that we have been in that business.

I am also a local government elected official. I am a township commissioner, and I understand something about the liability process and problems from the standpoint of local government. I also chaired the statewide effort for product liability reform in the State of Pennsylvania for 2 years, until out of frustration I decided that I would get involved in something that I could accomplish, and asked them to name another chairman for that effort.

The NFIB testimony: First of all, the members feel that in the liability insurance crisis that the first to feel it are the average NFIB member. The liability insurance issue is the top critical issue in the small business problems and priorities of our investigation.

The NFIB field force of over 700 regularly conduct surveys which indicate that the insurance problem is still a top problem. The White House Conference recommendation was No. 1 on the liability insurance issue. I was very active in the conference from the beginning in Pennsylvania, as was Barbara in Maryland, to the White House National Conference in August.

We need a comprehensive solution to the liability crisis. The problems include an out-of-control tort system, poor insurance industry business practices, and a patchwork quilt of haphazard State regulations.

We definitely need tort reform. The civil justice system is being undermined by excesses. These excesses translate into higher costs and uncertainty for insurers. They also reduce the competitiveness that we have in the world economy and marketplace.

The NFIB supports comprehensive tort reform legislation such as that contained in the major product liability bills, including provisions to eliminate joint and several liability, modified competitive negligence standards, et cetera.

We also feel that the insurance industry needs reform. We need to recognize that the discretion by insurance companies in canceling or not renewing policies is harming small firms. We need to review the antitrust exemption in the McCarran-Ferguson Act because it distorts the market.

The antitrust exemption is a special privilege which is not justified by the industry. And the question of noncompetitive actions occurring in the industry need to be looked into. The NFIB does oppose the federalization of insurance.

To conclude our testimony, first, the liability crisis still exists for small business. And second, a comprehensive solution is needed. Thank you.

[Mr. Reinhardt's prepared statement follows:]

PREPARED STATEMENT OF RICHARD REINHARDT, PRESIDENT, PII AFFILIATES, LTD., ON BEHALF OF NATIONAL FEDERATION OF INDEPENDENT BUSINESS

On behalf of the over 500,000 members of the National Federation of Independent Business, I would like to thank you, Congressman LaFalce, for holding these hearings on the impact of the liability crisis on small business and to the rest of the Small Business Committee members for participating in them.

As you may know, the National Federation of Independent Business has been concerned over the years about the general issue of insurance. NFIB primarily represents main street and rural small businesses -- the average member employs less than ten individuals. NFIB members could be considered a leading indicator of the economy. When the general economy prospers, our members generally prosper. When the economy does not do so well, our members generally feel immediate economic pain through lower sales of goods and services.

Because NFIB represents such a cross section of small business, we believe we can say with certainty that NFIB speaks for America's entrepreneurs. And the concern dominating entrepreneurs' thoughts is insurance.

NFIB members were among the first to feel the so-called "liability insurance crisis" experienced in our country over the past several years. It's appropriate to use the phrase "liability insurance crisis" because many saw no logical or market-based justification for small business liability insurance premiums dramatically increasing in price regardless of their risk rating, and for the significant cut many faced in insurance coverage. NFIB has received many calls and letters from small business owners who were good risks for liability insurance policies but who cannot even get insurance, no matter the price, because policies were no longer offered.

I am here before this committee today because the liability insurance issue is probably the most critical and serious issue confronting small business. NFIB's Institute for Enterprise

Advancement issued its Small Business Problems and Priorities in June of last year, ranking the top 75 problems small businesses face. In that survey, small business ranked the cost of health insurance as its number one problem area, with 33% of those sampled noting it was a critical problem. They ranked the cost and availability of liability insurance as the number two problem. However, 38% of small business viewed this as a critical problem, the highest percentage describing a problem as "critical" in the survey.

Furthermore, NFIB's field force of over 700 individuals regularly conducts a field survey with small businesses across the nation to get a sample of their views and concerns. The last two field surveys provided them with the following data:

- Asked the question of which issue is the most important affecting business, 44% chose liability insurance;
- Asked if liability insurance premiums had increased by 50% or more, 41.5% said yes.

These field surveys reveal to us, Mr. Chairman, that the liability issue has not gone away.

Furthermore, the number one priority at the national White House Conference on Small Business, made up of 1,813 delegates and held in Washington last August, was the liability insurance issue. I, incidently, was quite involved in the White House Conference Recommendation on liability insurance as a delegate.

All of this data tells me and NFIB that the insurance issue is on the minds of small business owners everywhere and that action must be taken to resolve the problem.

While you may have heard examples of small business difficulties with liability insurance, I would like to give the committee some examples of problems generally being faced by NFIB members. They include:

--A laundromat owner in Corpus Christi was sued because a lady was mugged in one of his laundromats. He refused to pay, but his insurance company settled with the lady out of court. In 1985 he paid $900 for$2 million in coverage. In 1986 he is paying $3,625 for $1 million in coverage.

--A small chemical company (14 employees) in Gulfport, Mississippi paid $4500 for $300,000 coverage. In 1986 they have been quoted a premium of $38,000 for $500,000 coverage.

--A campground in Hagerstown, Maryland in 1985 was charged less than $1000 for $1 million in coverage. In 1986 the same coverage costs $8000.

--A plumbing and heating contractor in Warren, New Jersey received notice that his policy had been cancelled without explanation.

--An aircraft corporation in Waco, Texas paid $25,000 in 1983, $50,000 in 1984, and $200,000 in 1985 for $2 million in coverage.

--A five-and-dime store in New Lexington, Ohio has seen premiums increase 20% between 1984-1985 and 50% between 1985-1986.

--A manufacturer of food processing machinery in Marblehead, Ohio paid $50,000 with a $2500 deductible in 1985. In 1986 the premium is $150,000 with a $50,000 deductible. The 1986 policy would also require the manufacturer to pay legal expenses for settling claims and to provide a letter of credit to the insurer in the amount of $300,000.

--An elevator repair and maintenance company on Staten Island paid $3500 for $5 million in coverage in

1984. In January 1985 the policy cost $17,500. In July 1985 the policy was cancelled. Another carrier has offered coverage for $72,000 in annual premiums.

--An auto parts and towing company in Walton, Ohio is being charged $20,000 this year for coverage which cost $11,000 last year.

--An insurance agent in Boundbrook, New Jersey received notice from two companies that they were no longer accepting any applications for commercial liability insurance. Also, these companies were reviewing all renewals for possible termination.

NFIB believes there must be a comprehensive solution to the insurance liability crisis. We believe that there are three causes which have contributed to the problems facing us today:

(1) An out-of-control tort system;
(2) Poor insurance industry business practices;
(3) A patchwork quilt of haphazard state regulations.

Recognizing multiple causes of the problem requires us to look at multiple solutions. It would be irresponsible to attack one problem area, resolve it, and then walk away from this issue thinking it is solved. There must be a comprehensive approach and solution.

Furthermore, NFIB members do not want to single out one individual, group, or institution to blame for the crisis. They only want it resolved so they may go about their business -- the business of small business, generating new wealth and creating virtually all the new jobs in this nation.

NFIB members believe an appropriate approach should include a national uniform product liability law, comprehensive tort reform, and pro-competitive changes made in the current structure of the insurance industry. It is not the intention of NFIB to "bash" insurance companies, lawyers, or state regulators in attempting to jawbone the price of insurance down and to expand its coverage. It is and will be our aim to work for those fundamental changes which will bring about better coverage at a lower price.

NFIB Mandates

As you probably know, The National Federation of Independent Business is a lobbying group which bases its policy on the views of its membership. Issue positions percolate up from grassroots, rather than being imposed on the more than 500,000 members from our President or the Board of Directors.

NFIB is very proud of its decision-making process, most especially because it keeps in close touch with the issues important to the membership.

NFIB hears from the membership by a combination of surveys, meetings, daily contact by our field force, and through the use of the Mandate. The Mandate, in particular, is a bi-monthly poll sent to all members to solicit their views on issues. Members are asked to take a position on an issue based upon their own beliefs and experiences. They are provided with an objective background summary on the issue. The members complete the Mandate and send it back to NFIB. The results are tallied and used for work on Capitol Hill. All of you receive a summary of the Mandates from NFIB so you, too, know what your small business constituents are thinking. Using the Mandate is how NFIB has developed its position on insurance. The following positions represent the basic views of NFIB members on liability insurance reform:

	Membership Mandate Vote
*Comprehensive tort reform (return to a fault-based standard, elimination of joint and several liability;	81% Favor 10% Oppose 9% Undecided
*Uniform national product liability law;	65% Favor 27% Oppose 8% Undecided

*An expedited claims process;	65% Favor 23% Oppose 14% Undecided
*Federal minimum standards for insurance companies to follow; and	26% Favor 67% Oppose 7% Undecided
*Elimination of the antitrust exemption provided in the McCarran-Ferguson Act.	60% Favor 26% Oppose 14% Undecided

The Cause of the Crisis

There is, as you know, wide disagreement on the cirumstances which led to the current crisis. The main dispute is between the insurance industry and the trial lawyers. The insurance industry lays most of the blame for the situation on the attorneys and the civil justice system. They claim that excessive litigation, overly generous court awards, and greedy attorneys have strained insurance reserves and thus raised the costs of underwriting. While admitting that they underpriced insurance to gain investment capital when interest rates were high, they maintain that tort reform is the answer to the problem.

The attorneys accuse the insurance companies, disclaiming the notion that Americans have become more litigious and that attorneys do little to discourage frivolous lawsuits. They contend that most of the problems are due to poor management of investments made by the insurance companies, and they point to the companies' strong performance in the stock market as evidence of the healthy financial status of the industry as a whole.

Still one other group must be mentioned. State regulators -- the insurance commissioners -- have done little finger-pointing except at erroneous predictions regarding interest rates, upon which they made many decisions. Although they must operate within statutory limits, they all have authority to review rates either before or after implementation. However, like state tort law, the theory and practice of insurance regulation varies widely from state to state.

We see some truth to all sides' arguments.

Tort Reform

There are a number of reasons behind supporting comprehensive tort reform. First, there is no question that the operability of our civil justice system is being undermined by excesses. Million-dollar awards are becoming more commonplace. Court caseloads are growing by leaps and bounds. Tort reform is needed to address these problems.

Second, these excesses translate into costs and uncertainty for insurers. Controlling awards and contingency fees and limiting liability will help control insurers' costs and help them determine risk, consequently reducing premiums and improving insurance availability.

A third reason to support the proposed legislation is to keep U.S. companies competitive in the world marketplace, Domestic companies that move off-shore to avoid high costs of insurance reduce the number of manufacturers among which to spread risk in this country and thereby, cause insurance rates to increase. It is a Catch-22.

Finally, tort reform has been thoroughly studied, and there is relatively widespread familiarity with the concepts involved.

NFIB is a charter member of the American Tort Reform Association (ATRA), a coalition of business groups in favor of tort reform. NFIB membership supports tort reform at both the state and federal levels. In addition to the Mandate polls noted above, in twenty-four states, NFIB state directors have polled member opinions on various reforms of state tort law, and those results have likewise indicated their support. We support the following reforms, which many of the state legislatures have either passed or are considering:

1. Cap awards for noneconomic damages,
2. Limit contingency fees,
3. Implement alternative dispute resolution (ADR) mechanisms,
4. Penalize parties that engage in frivolous litigation,
5. Modify pure comparative negligence standards,
6. Abolish joint and several liability,
7. Require judges/juries to itemize elements of awards,
8. Require judges/juries to consider collateral sources of compensation in determining awards,
9. Eliminate "ad damnus" clauses,
10. Allow payments of awards in installments.

Major tort reform legislation has been introduced in both the House and Senate. Congressman Bill Richardson of New Mexico has introduced H.R. 1115, a comprehensive product liability reform bill. While the bill does not include all reforms we might like to see, it is a good compromise and a start down the road toward improving our civil justice system with regard to product liability cases. H.R. 1115 has engendered widespread support from the business community. In the Senate, Senators McConnell, Kasten and Danforth have introduced bills addressing the need for tort reform. Senator McConnell's bill, S. 554, offers comprehensive tort reform, encompassing more than just the product liability area. The

Danforth and Kasten bills, S. 666, S. 687 and S. 688, focus specifically on product liability and offer substantial reforms in this area. In addition, the Administration has proposed tort reforms, introduced as S. 711 in the Senate and as a part of their competitiveness package H.R. 1155, in the House.

These bills include the types of reform NFIB supports. Only one provision contained in some tort reform proposals gives NFIB members concern and is one over which the business community is split. That provision is the elimination of the employer's right of subrogation. NFIB members voted 71% in opposition to elimination of it. Currently most states allow an employer to recover from the manufacturer the cost of workers compensation payments made to an employee who wins a product liability suit. Federal preemption of state law in this regard is not pure tort reform and should not be part of a tort reform package.

Overall, these bills do promote the reforms we desire. While this committee does not have direct jurisdiction over the bills, we urge you to use your influence on behalf of the small business community to urge the committees of jurisdiction to act on these tort reform proposals.

Insurance Industry Reform

Has the market failed? That is the fundamental question many are asking today about the insurance market because its answer has profound public policy implications. The industry itself has blamed the soaring premiums and reductions in coverage on previous cut-throat competition, i.e. too much competition among those in the industry. Other experts have argued that there exists a business cycle for insurance; we are currently experiencing the "bust" of the cycle, with better times to follow. There are others who believe the market has failed and offer the solution of increased federal regulation. No consensus has emerged to answer this question.

NFIB believes the market process itself has not failed. We view the current, complex insurance environment as one in which competition within the market has been hindered.

Our membership is generally concerned about the exercise of discretion by insurance companies in cancelling or not renewing policies. Notification periods are often short, and little if any explanation is given to the policyholder. Claims history seems to have no bearing on an insurer's decision to cancel or not renew. Industrywide cancellations leave insurance agents hard pressed to obtain coverage for clients, and small business owners have neither the time nor the expertise to seek out coverage for themselves. These are problems which insurance companies must come to grips with and solve. Not resolving these problems will increase the demand for more federal regulation of the industry.

One particular example of current law which hinders effective competition is the antitrust exemption contained within the McCarran-Ferguson Act. NFIB believes that the exemption contained within the law distorts competition in the insurance industry by its very existence.

It is the distortion of the market which compels us to urge this committee to repeal the antitrust exemption contained with the 1945 law.

The repeal of the antitrust exemptions contained within the McCarran-Ferguson Act makes sense for two reasons in today's environment. First and foremost, there is no market-based reason why there should be an antitrust exemption. Because there is no market-based justification, continuing the exemption is unfair and represents intrusion in the free economy by the federal government. Our antitrust laws were instituted to set the parameters for competition. Exemption from these laws represents a special interest granted to a specific industry. NFIB members want to see a level playing-field for all companies, including those in the business of insurance. They believe the antitrust exemption hinders competition.

Second, the reason for the continuation of the antitrust exemption, passed by Congress to ward off a court-inspired regulatory crisis, no longer makes judicial sense. We need to simply accept that the business of insurance is, in fact, interstate commerce and needs to be under the scope of antitrust laws.

Should legislation come before the House for consideration which would eliminate the anti-trust exemption in the McCarran-Ferguson Act, Congress should continue to insist that the business of insurance be regulated by the states. State regulation of insurance must continue to be the clear intent and priority of Congress. Furthermore, there may need to be some legislative language added to the bill which makes clear the understanding that joint historical data collection is important for small and mid-sized insurance companies; this would be one more assurance that pro-competitive activities would continue.

I would like to point out, Congressman LaFalce, that while NFIB supports the elimination of the anti-trust exemption contained within the McCarran-Ferguson Act, NFIB membership does not support the "federalization" of insurance regulation or the establishment of a new agency or department to oversee the insurance industry.

There is a limited role for the federal government to play in this issue; that is, one of analysis. NFIB has been encouraged by the recent statements of Federal Trade Commission Chariman Dan Oliver, who has said he would like to investigate the business of insurance. NFIB believes Chairman Oliver would parallel many of their concerns, pursuing a policy to increase competition so insurance coverage will be more affordable and allow for greater coverage. Although the prohibition Congress placed on the FTC in 1980 is under the jurisdiction of the House Energy and Commerce Committee, NFIB hopes that you relay to your colleagues our interest in this issue.

Conclusion

Representing the more than 520,000 members of the National Federation of Independent Business, I want to impress upon you Mr. Chairman and members of the Committee that the liability insurance crisis has not gone away. We look to you, our legislative branch, for assistance in resolving the problems which contributed to the crisis we are currently going through and, equally important, taking the necessary steps to ward off another crisis in the future.

Small businesses, many of which are marginal firms to begin with, have felt the severe impact of the liability crisis. Quite a number of businesses could simply no longer afford coverage, when coverage was available, and had to close their doors. Still other firms saw their profit margins evaporate or had to pas their skyrocketing premiums directly on to their customers in the form of higher prices. Clearly, as a result of the crisis, we experienced less job creation, less "competitiveness" and lower economic growth.

This committee has a crucial role to play as ombudsman for the small business community. I hope, and the members of NFIB hope, that one of your top legislative priorities is resolving the liability insurance crisis.

Thank you Mr. Chairman.

Chairman LAFALCE. Thank you very much, Mr. Reinhardt.

Mr. Hayes, what data do you have with respect to the justification for the increase in premiums that are charged, or do you have no independent data base and you have to rely upon whatever data base that the companies or ISO itself provides?

Mr. HAYES. That is correct. We do not maintain an independent data base.

Chairman LAFALCE. All right, fine.

Do you take issue with, or would you be in agreement, or would you just not know the validity of the survey referred to by Mr. Swain when he said that it appears that there has been no increase in claims, no significant increase in claims, being experienced by small businesses at least on the basis of his survey; what is your experience, Mr. Hayes?

Mr. HAYES. I have not seen the survey that you referred to. But Mr. Chairman, our experience has been that the statistical data that is gathered is so comprehensive and so actuarially sound that it does represent a basis for the pricing of the insurance product. It has been argued——

Chairman LAFALCE. It does or it can?

Mr. HAYES. The abandonment of actuarial principles in favor of cashflow underwriting was wrong. It created the situation that we find ourselves in today. The slashing of rates without any foundation was wrong, and it goes against the basic tenants of the insurance industry.

We have argued effectively on the part of the industry that insurance is not gambling. Insurance has statistical data that each one of us in this room have been the objects of. The type of car we drive, the age of the driver, our driving record. All of these things go into creating a data base that is actuarially sound so insurance can be priced accordingly.

It is our feeling that the crisis has been much contributed to by the fact that insurance was under-priced. Though a part of the industry, brokers do not have the birthright of price and selection. Only the underwriter has that.

The product was so severely under-priced during the soft market that the reaction was not a response but a reaction. And during the hard market, there was no actuarial premise for the pricing that took place. Pricing was not supported by experience in either one of these markets. But from the consumer's standpoint, it still did reflect in the soft market a more competitive and cheaper insurance product.

What we maintain is that there is a balance somewhere. The soft market is so deeply under-priced and the hard market so severely over-priced that this is what creates the economic displacement, and this is what drives the small business person out of business. They just plain cannot afford insurance even if it is available.

Mr. MAZZOLI. Mr. Chairman, let me ask a question at this point if it is possible.

Chairman LAFALCE. Sure.

Mr. MAZZOLI. I am really curious about what Mr. Hayes says. Because it seems to me that the logic of what you are saying is that if an insurance company makes a mistake, then they should be able to make up for that mistake by over-charging in the future.

Mr. **Hayes**. I cannot, Mr. Mazzoli, speak for the insurance industry. All I can do is stand on the fact that they spend a lot of money in gathering——

Mr. **Mazzoli**. But you would have said the same thing 4 years ago when they charged too little. You would have probably sat in this committee and said that there is actuarial data to support their charges, as you are sitting here today saying that there is actuarial data to support these charges. Yet Ms. Balter says that she went from $30,000 to $215,000 in experiences which suggest no lawsuits at all.

Mr. **Hayes**. That is one of the products of the business, the fact that there are those classes.

Mr. **Mazzoli**. That is rapacious, that is all that is. There is no explanation for it, simply no explanation.

Mr. **Hayes**. I think that it would be difficult to try and explain it, because it truly is complex.

Mr. **Mazzoli**. Talk to the lady who is trying to make a living, you know. It is not my time, it is the chairman's time. But it seems to me that you are defending the indefensible.

Mr. **Hayes**. There are times that we feel that way. As I said earlier, there is a total picture here. The ideal would be to flatten out the cycle so we could avoid these horrendous peaks and valleys. Following the actuarial data available would make that possible.

Now Mr. Mazzoli, you do have to tie in tort reform as my colleague here testified. There is the joint and several problem. You do have to tie in some part of the tort reform as a contributing factor to the problem. I am not smart enough to say to what degree it contributes, but I think that we see from her examples that, too, is difficult to cope with.

Chairman **LaFalce**. Let me reclaim my time and ask a few questions.

Ms. Balter, on page six of your testimony, you make a number of factual statements, and therefore I would inquire as to the source of your facts. You say that in 1984 that there was a private civil lawsuit for every 15 Americans, and that, from 1970 to 1981, the number of civil lawsuits in State courts grew four times as fast as the population.

What is the source of your information?

Ms. **Balter**. The data was taken from Best's insurance management reports, the December 30, 1985 issue.

Chairman **LaFalce**. The December what?

Ms. **Balter**. December 30, 1985, is the footnote that I have on the Maryland page.

Chairman **LaFalce**. I did not know that Best's was in the business of collecting information on the number of civil lawsuits in the State courts.

Ms. **Balter**. Oh, I am sorry, civil lawsuits.

Chairman **LaFalce**. Yes.

Ms. **Balter**. I have that 12 million lawsuits were filed in State courts. The footnote that I have is George Church, I am sorry, George J. Church, and the name of the document is "Sorry, Your Policy Is Canceled." That was in Time magazine, March 24, 1986.

Chairman **LaFalce**. Who is George Church?

Ms. **Balter**. He is a reporter for Time magazine, I assume.

Chairman LAFALCE. Did he, in his article in Time magazine, indicate where he got the information that the number of civil lawsuits in State courts grew four times as fast as the population during that period of time?

Ms. BALTER. Not that I am aware. He did a cover story on the insurance liability issue.

Chairman LAFALCE. You see the problem that I am having. I remember a decade ago when every single witness who came before my committee testified that there were 1 million product liability lawsuits being brought every year. And this was accepted as a given by virtually every single trade association and every single witness, and it appeared in national advertisements.

And then we got the insurance industry to conduct a closed claims study. They concluded that the 1 million figure was exaggerated by approximately 800 percent. And yet it formed the primary basis for the formation of the subjective judgment of the individual insurance underwriter.

And therefore, I feel that it would be not only desirable but very necessary to ask all witnesses that if they are going to give me facts, they also give me the source of their facts.

Let me ask the source of your fact for the average product liability award exceeding $1 million in 1984. I find that very interesting, that the average product liability award exceeded $1 million in 1984.

We had similar allegations about a decade ago. But after the closed claims study, it appeared that the average payout per claim was not $1 million. Instead it was a little more than $300,000.

And so I am curious as to the source of your information for an average product liability award exceeding $1 million in 1984?

Ms. BALTER. May I say to you that the position paper that was done for the State of Maryland is footnoted and has a bibliography attached to it.

Chairman LAFALCE. What is the source of information for that statistic in particular?

Ms. BALTER. That statistic is footnoted, and I will have to find it in the paper. That statistic comes from Mr. Church's article.

Chairman LAFALCE. In Time magazine?

Ms. BALTER. In Time magazine, right, of March 24th.

Chairman LAFALCE. All right. The point that I am attempting to make is that we have to be very careful. Very often mistruths can be repeated so often that people do not know that they are mistruths.

And I can give you unbelievable examples of incorrect information being disseminated months and years after corrections have been made simply because the initial spread of the incorrect information was so great that the remedying of the incorrect information was 100 times less than the dissemination of the incorrect information in the first instance.

And I do not know whether this information that you are giving me today is correct or incorrect. But, obviously, it is based primarily on an article in Time that gave no source for its information, so I have to be a little careful about it.

Ms. BALTER. No; I am not saying that. Time magazine could very well have given a source. In preparing this paper, I read dozens, perhaps close to a hundred articles, and this is a distillation from my notes.

Chairman LAFALCE. I do know that we did have a witness before a subcommittee that I chaired in the last Congress, the executive director of the National Center for State Courts. And that executive director for the National Center of State Courts said that his organization probably has the best information available in the entire United States of America regarding claims in State courts. And his testimony was that the number of civil lawsuits in State courts increased almost exactly proportionate to the increase in population.

So there seems to be, on the basis of his study, which to my knowledge is probably the best study and the best body of data available in the United States today, a tremendous discrepancy between the information that he gave and the information that you are using. So your data is troublesome.

Ms. BALTER. You are correct. But I think that in my experience that I have also found that the same statistics can be used in many ways.

Chairman LAFALCE. Surely.

Ms. BALTER. I am testifying as a small business owner who runs a small business, and who spent a lot of time reading a great many articles and footnoting them to produce a paper for the White House Conference. I do not have the staff nor the time to go back and check the credentials or the statements made in every article and every book that I read.

Chairman LAFALCE. I appreciate that, and of course not. Nor do 99 percent of the people who speak on this issue, but yet everybody still speaks on it. And that is how it is difficult to get good information on which to make public policy judgments.

Because, very often, we repeat what other people said without being aware of the validity of what the other people said. So if you repeat something often enough, it becomes accepted as an absolutely irrefutable truth. And this is something that we have to be careful about.

Ms. BALTER. I understand that. I spoke with the Pratt Library yesterday afternoon, and she did not refute that figure. The librarian who did the research on it told me that the last available data as far as she knew was 1984. But information can perhaps be garnered in Williamsburg, VA, on the latest data relative to the insurance crisis. By that time it was 5:00, and I could not go to Williamsburg to update any of these figures.

Chairman LAFALCE. Yes; I appreciate that.

Do you have any other questions?

Mr. MAZZOLI. Mr. Chairman, thank you very much.

First, let me salute you. At least you came in, Ms. Balter, with data.

Chairman LAFALCE. Surely.

Mr. MAZZOLI. I say that I want to salute you, because you came in here with data that you were at least able to footnote, which is probably more than some of us could do if we were to be forced with the same issue.

Mr. Hayes, let me ask you this question. On page three, if you would refer to page three of your statement, the second full paragraph intrigues me. I can understand why you are probably trying to be diplomatic here, because after all you represent the insurance companies. You suggest that there are some slight problems, but basically things are improving.

And then in the full paragraph two you say:

> There are coverages that remain difficult to find. For example, insurance for chemical, pharmaceutical, architectural, lawyers, doctors, accountants, insurance brokers, directors and officers of corporations, product liability, environmental impairment or pollution coverage remains almost unavailable.

I mean I would suggest that that just practically blankets what most people do.

What then is really available except for automobile liability coverage?

Mr. HAYES. First of all, Mr. Mazzoli, I do have to say that by definition that the broker is the representative of the insured. So I do not represent the insurance companies, but I represent your constituents.

Mr. MAZZOLI. So, by definition you are a good guy.

Mr. HAYES. I am a good guy.

Mr. MAZZOLI. You get to wear a white hat as against the other color.

Mr. HAYES. That statement does not blanket the whole industry. I would go back to what I said before, in an attempt to solve this crisis that we are in, that statistical data is available, and the underwriters are the people who have that data. It is the departure from what that statistical data indicate as proper adequate pricing that creates the peaks and the valleys.

Mr. MAZZOLI. Well, let me ask you something. You have suggested—which is kind of interesting and we talked about it earlier—that you should take not a snapshot but a moving picture. So that Ms. Balter ought to be very happy even though she is paying $300,000 this year, because 3 years ago she was only paying $30,000. Because we now find that $30,000 was impossibly low and that it was a give-a-way, and all they wanted was $30,000 to invest or do something else with.

But that she ought to be, in effect, prepared to take the mid point between $30,000 and $215,000 because that is really what the adequate thing is.

I mean is that about what you are saying, to just look to the longrun?

Mr. HAYES. I do not really know. I would hope that something like that would probably follow. But there again, unless we really get in and study these numbers, can we be certain. The characteristics, Mr. Mazzoli, of the company that Ms. Balter runs should determine to a large degree what the price is for her professional exposure.

Mr. MAZZOLI. That is right. But apparently, it does not. Because apparently, the insurance rates are not made so discretely enough that they single out her company which is practically blemish free and give her the rates to which she would be entitled, but in fact they lump her presumably into certain larger categories which possibly have a bad record.

But at the same time I think that you are going back to saying that the $30,000 was too low, so we have to reconcile ourselves to $200,000.

Well, let me tell you where the fallacy lies. The fallacy lies in what Mr. Reinhardt said, and that is that possibly, McCarran-Ferguson protects those insurance companies, because perhaps, now they can set rates collusively. I do not say that they do, but they could. And that gives them the opportunity to outrageously overprice what they are currently getting in order to make up for their misbehavior or their lack of prudence 4, 5, 7, or 10 years ago.

Take a look at the banks. The banks made some improvident loans. They cannot now go back and charge us a lot, because you have competition. You have other banks beating the price, and there is a little bit of opportunity for competition to keep these high peaks from arising. The reason why you have these huge peaks is because you probably have antitrust protection.

Am I right or wrong?

Mr. HAYES. I do not know. I honestly do not feel that I am qualified to discuss the antitrust implications.

Mr. MAZZOLI. Well, let me ask Mr. Reinhardt, because the NFIB was very fervent about this in your statement that McCarran-Ferguson ought to be not only looked at but changed.

Tell me, do you think that part of what Mr. Hayes was saying is we need to try to squash down these peaks and valleys—that it would be better if we flattened them out? Do you think that the McCarran-Ferguson keeps you from flattening out those peaks and valleys?

Mr. REINHARDT. Well, I guess that I would have to answer in two ways. One, of course, is the testimony that I gave from our membership primarily, and the other would be my own individual viewpoint.

From my personal experience, it would seem to me that there is inadequate information to properly determine the answer to your question. And the reason they might be is the McCarran-Ferguson Act may be giving the ability to not have to come forth with that information.

Mr. MAZZOLI. In effect, if you go behind a closed door to set a rate instead of doing it out front.

Mr. REINHARDT. I am making a supposition, but it seems a logical one.

Mr. MAZZOLI. Well, I do not want to take too much time, as everybody is busy. I really started out, when I approached this subject, thinking that maybe McCarran-Ferguson was being set up for the villain unnecessarily, and that there might be something else involved.

But the more that I have sat here this morning and listened, I began to think that maybe there might be some point and purpose in looking into that, if it might be producing these very high peaks and valleys. I thank you, Mr. Chairman.

Mr. REINHARDT. I might just say one other thing. From my company's experience, I had brought 1981 through 1987 insurance costs versus coverage limits on our own company.

And they range from 1981 from a $37,000 premium to, in 1986, a $53,000 premium with the low premium of $16,000, and a current premium of $30,000, and the coverage from $4 billion to $8.5 million back to $4 million. So there would seem as though there is very little relation in those costs and coverages to experience.

Mr. MAZZOLI. Yes.

Chairman LAFALCE. I am going to be calling on Mr. Mfume and Mr. Eckart shortly for any questions that they might have. Today's hearing is exclusively on the extent of the problem of the availability and the affordability of liability insurance for small businesses. We do not attempt to address any solutions. Or maybe we should not even use the word "solutions," but any legislative actions that might help alleviate the problem either to a minor degree or to a major degree.

Mr. Mazzoli has indicated considerable interest in McCarran-Ferguson. Undoubtedly, it is due in part to his membership on the House Judiciary Committee. There have been many calls for either repeal or modification of McCarran-Ferguson. I started making that call a decade ago, and I introduced a series of bills taking different approaches.

I first introduced those bills in 1978, and have reintroduced them every year since. Even having done that, I am not convinced that it is going to have that much of an impact on the problem. I think that it is highly desirable, but I do not know how much of an impact it is going to have on the extent of the problem.

We ought not to kid ourselves. There is a big difference between McCarran-Ferguson and Federal regulation, for example, or State regulation. There is a big difference between an exemption under Federal law and the State antitrust laws to which insurance industries might be subject.

The big difference between McCarran-Ferguson's exemption from antitrust and the Federal prohibition against the FTC even investigating the practices or studying the practices of the insurance industry is something that Congress imposed in 1980.

Mr. Eckart, who is chairman of the Antitrust Subcommittee, will be looking into this aspect of the liability insurance crisis in considerable detail, I understand. I believe that he is contemplating hearings on the ramifications of all of those issues, and we will look forward to his hearings on that with great interest.

Mr. Mfume, are there any questions that you have?

Mr. MFUME. Thank you, Mr. Chairman. Just a couple of questions.

Ms. Balter, let me first of all congratulate you on your election to the presidency of the NAWB.

Ms. BALTER. Thank you, sir.

Mr. MFUME. And having interests in the Baltimore region, I look forward to working with you.

I want to thank you also for attempting to—at least as my colleagues said, come in here with some data. I understand our chairman's desire and his concern regarding validity of numbers because it does, in fact, make it difficult to set public policy if we have got three or four sets of numbers.

In fact, it is an appreciation that I have grown into. I have tried to convince many of my opponents to do the same thing. Unlike you, they did not feel compelled to pay me much attention.

Let me talk about some numbers that are verifiable though. You spoke in your testimony about an engineering firm having gone from an annual liability premium of $34,000 to $66,000 to $90,000.

Ms. BALTER. That is my firm, sir.

Mr. MFUME. OK. And then the travel agency with an annual premium of $536 to an annual premium of $5,639, 30 days ago.

I assume that you and those who went and participated in the White House Conference felt to some extent like you were being held hostage. But would there not be other hostages involved? What about the American consumer? Doesn't he or she in the long run pay for the sort of premium increases that you are faced with?

Ms. BALTER. Absolutely, absolutely. There is no business that can absorb these costs. It is always passed through or an attempt is made to pass through.

Mr. MFUME. How do you expect, at least in your case, that that is going to affect your business and your ability to attract new business?

Ms. BALTER. It has probably had a considerable impact on my business because this is the simplification of what is happening. The insurance company had charged me, after I had insurance policies for a number of years without any claims, a so-called one-time-only additional premium to give me first-day coverage. That meant that all of the projects I had worked on from the first day I went into business would be covered by my premium. When they no longer chose to insure my business and other businesses in our industry, they wiped out the first day coverage. I had no choice, I had no options. And now I have some 10,000 jobs that will probably never be covered again because the insurance companies, I am sure, were looking to get rid of their long-term liability or potential liability, and with one fell swoop, they dumped it back on me.

Now, I do not understand what the one-time premium was supposed to indicate if they had the right to do what they did. And that is one tremendous aspect. Now, what I am——

Chairman LAFALCE. Did most companies in your line of business have a different type of insurance policy when they started out? What type of policy did you have that would not have——

Ms. BALTER. Just E&O, errors and omissions.

Chairman LAFALCE. Mr. Hayes, can you help us out on this? If she had a policy when she started out in business, shouldn't that policy have covered her for so long as an incident might occur in the future? Why is she in need of a policy now that would go back to day one?

Mr. HAYES. Mr. Chairman, what you have in the errors and omissions field is described as a claims made policy.

Chairman LAFALCE. When did you go in business—10 years ago or however many years?

Ms. BALTER. When I first was covered?

Chairman LAFALCE. Yes.

Ms. BALTER. Oh, yes; it has to be probably 16——

Chairman LAFALCE. All right, 16 years ago.

Ms. BALTER. A long time.

Chairman LAFALCE. Did you have a claims made policy at that time? Did you not have a long-tail policy at that time?

Ms. **Balter**. At that time, yes; I paid additional money for it. Now, they are not offering that.

Chairman **LaFalce**. Wouldn't that long-tail policy cover you today, tomorrow, et cetera?

Ms. **Balter**. Apparently they tied the tail to the insurance policy, and when they do not renew the insurance policy, you lose the whole thing.

Chairman **LaFalce**. Would you explain that to us, Mr. Hayes? Is that accurate? I don't think so.

Mr. **Hayes**. My interpretation would be that if in the beginning she had an occurrence policy, when the occurrence takes place, this triggers the coverage.

Chairman **LaFalce**. Even if you sever your policy thereafter.

Mr. **Hayes**. Right, exactly.

Chairman **LaFalce**. I am just having a little difficulty understanding your situation, to be quite honest with you.

Ms. **Balter**. I am too, because I was told that I do not have coverage on those 9,000 projects.

Chairman **LaFalce**. If you had a long-tail policy at the time of those projects, for the life of me, I do not know why you wouldn't have coverage. I am speaking only as an attorney with a little bit of knowledge about insurance.

Mr. Hayes, you are president of the National Association of Insurance Brokers. What is your judgment?

Mr. **Hayes**. My judgment is that an occurrence policy, which was the type that were in vogue at the time, will pick up that coverage. The claims made is so written that it will only pick up a claim that is reported in the 12-month period.

Chairman **LaFalce**. But claims-made policies are relatively new phenomena.

Ms. **Balter**. That's new.

Chairman **LaFalce**. I honestly would consult with Mr. Hayes after this hearing, Ms. Balter.

Ms. **Balter**. I would be happy to consult with Mr. Hayes. I consulted with my insurance broker many times over because of this, now, tremendous lapse in coverage. And I understand I am not covered. Insurance companies have stopped writing this insurance. What does one do if the insurance company stops writing the insurance or goes out of the insurance business?

Chairman **LaFalce**. I interrupted you, Mr. Mfume.

Mr. **Mfume**. That is OK.

Chairman **LaFalce**. Please, reclaim your time.

Mr. **Mfume**. Thank you.

Chairman **LaFalce**. I apologize, but I was troubled by your testimony from the very beginning when you kept referring to the fact that your need to get a policy now which gives you first day coverage.

Ms. **Balter**. All right. Let me finish the story.

From what I understand I do not have first day coverage. That lapsed with the insurance company that decided they were no longer going to write insurance for geotechnical engineering firms, and when an insurance company stops writing insurance, where does one go to claim? Where?

To answer the second part of your question, what is happening now is that many insurance companies have required—I do not like to say, through the back door, but they have required, or suggested to policyholders that they currently insure, that their subcontractors be covered by errors and omissions insurance. So, it almost becomes a restraint of trade if insurance companies refuse to write that insurance, and then say to architectural firms, structural engineering firms, those who are not in the specialty that I am in, that they should not use subs who are uninsured. They may not say it that openly, but in their loss prevention suggestions, and in the contracts they suggest the prime contractors write—they tell them to make certain that the subcontractors are covered by professional liability insurance.

Mr. MFUME. Mr. Chairman, do I have time for one other question to Mr. Hayes?

Chairman LAFALCE. Sure.

Mr. MFUME. Mr. Hayes, let me say I think you are a good guy, too.

Mr. HAYES. Thank you.

Mr. MFUME. We just happen to be on different sides of the fence. In your testimony you said early on that there was a major realignment under way, and that some of the major carriers were selecting to set flat rates or flat levels, and that higher deductibles and lower amounts were means of self-insurance, that we do it all the time in our car insurance, and that risk management was something that had to be looked at further. But you recommended also, risk retention groups as, perhaps, being the way out for small businesses.

But yet, in your testimony on page 6, you say that it is important to note that forming risk retention groups and captives is a costly and lengthy process that requires careful analysis of risk, as well as adequate capitalization, and that the range of risk management options for small businesses outside of traditional insurance is limited because forming captives and group pools may be too expensive and too difficult to administer. So, which is it going to be? Is it the way out or is it something that should not be attempted?

Mr. HAYES. Well, first of all, the risk retention group is not going to be a panacea. Let me give you an example. It might be easier to express. Let's say that there is a trial beginning today in California regarding this terrible thing that happened with the children. And so day-care centers became extremely difficult to place either from the availability or affordability perspective.

Now, our feeling as brokers, as representatives of a client, is that there is something we can do with that exposure of, let's say, molestation or child abuse. Let's just center on that for a moment, and let's say that we could form a risk retention group with the day-care centers and provide this coverage. But in order to do that, we would have to have adequate capitalization. And we would have to have the sound principles of risk management apply. Brokers then do take the position that almost everything except the moral risk can be insured because there is data.

The insurance underwriter community has a right of selection and price, and a broker does not care to invade that territory because if we look long and we look hard enough and we are innovative enough, there are things that can be done to make that risk a better risk. What we have not heard are the characteristics of either of my colleagues on this panel today relative to what they do, what their experience is, different things like that.

The industry itself, as I have said in my testimony, has to return to the fundamentals where the data is available. It is the application of that data in the pricing of the product that has been abandoned and led us to the insurance crisis.

Mr. MFUME. Thank you, Mr. Chairman.

Chairman LAFALCE. Mr. Eckart, any questions?

Mr. ECKART. Mr. Reinhardt, I had a chance to review your remarks, and I thought they were an excellent compendium of the problem of the five and dime, food processing, plumbing, heating, campgrounds, and other small businesses. A bowling alley in my district where the owner just rents during the bowling season and shuts it down during the summer, saw it's insurance costs increase from $600 to $16,000 and never had a claim for anything—I mean, on his property, bowling balls, beer bottles.

I want to draw to the witnesses and the committee's attention, a report that GAO released this morning to the Committee on Energy and Commerce. And that was the point I wanted to make with you, Mr. Reinhardt, having looked at your suggestions, tort systems, business insurance practices, and haphazard State regulations. GAO focused on it.

The point I wanted to make is in a 10-year analysis from 1976 through 1985, insurance companies enjoyed tremendous profitability. And over the past 10 years the average return for insurance companies has been comparable to all other industries.

It goes on to say that if the reserves were discounted for medical malpractice, for instance, you would find that medical malpractice showed an after-tax profit over the same period.

Established reserves for general liability showed an after-tax profit, a profit in excess of comparable other lines.

The Insurance Information Institute reported that the property casualty insurance earnings improved substantially and that their after-tax net profit increased from $9.7 billion to $19 billion.

What this suggests to me, if the horror stories that you and I know are very real for our constituents who pay these out of their after-tax profits is, maybe, it has not been so tough on the insurance industry. And in reality what they have been sitting on or enjoying is substantial profits in a wide variety of arenas. Medical malpractice, as I said, a $2.2 billion profit. Yet, doctors have been up here screaming about what the insurance companies have done to them. General liability, $8 billion, $8.0 billion in profits over the same period with a cumulative rate of return this past year of 13.4 percent. There is not a businessman or businesswoman on your list here that would not have loved to have had a 13.4 percent rate of return.

So, I suggest that your testimony has probably hit the nail right on the head. You may have been just a little too generous in underscoring what some of the problems are. I think we do need to get into tort reform. Some of the suggestions you make here on tort reform are long overdue.

But to cry poor little ol' insurance company blues may be just a little bit of crocodile tears on their part. They are above the profile for banking, transportation, public utilities, and almost as good as defense, an industry that we have known, Mr. Mfume, a tremendous profitability in the last several years.

I commend this study to the folks at NFIB because I think when we want to sit down and deal with what has been a crippling impact on our small businesses, we need to take a look at who has had the flexibility, who invested in energy and real estate in Texas, priced below their actuarial responsibilities, moved that profit over into cash flow, and earned enormous profits in periods of low inflation, and stuck your membership and our constituents with the bill. And that is a small part of the problem.

Tort reform is necessary in arenas where our constituents have their inability to go to the marketplace.

But failing to take into account insurance industry business practices, which you recommend, and a haphazard panel of State regulation—when I was in the State legislature, I chaired our insurance subcommittee. These folks just take us to the cleaners. When you talk about introducing a tough bill, they quickly say, well, we'll go to another State, or that ought to be the Federal Government. And then I get elected to Congress, and they come up and testify and say, well, that ought to be done at the State level. I mean, that reminds you that when the bank robbers hold up the bank, they always station somebody right by the front door who was part of the gang. When the sheriff came up and asked, "Which way did they go?" that guy would say, "They went that-a-way." Well, that is what the insurance companies are doing to us. They are doing it to you. They are doing it to the individual entrepreneur who makes no claims and goes on an occurrence-paid basis.

I know I still live in fear of all the cases that were left when I used to practice law that are still sitting out there.

But to my friends at NFIB and to other panelists, I suggest you take a look at this GAO report because it is damning in terms of where they have drawn their profits, how they have gotten there, and begging the question of how it ought to be answered.

Mr. Chairman, these hearings are extremely helpful. You are correct. My subcommittee is going to do some work on this at the end of this next month. We will have some fun with this matter because we just have no place else to go. I thank the chairman. I didn't really mean to make a speech, but I wanted to commend your recommendations in particular, Mr. Reinhardt, because I think they head us in the right direction.

Mr. **Reinhardt**. Thank you.

Chairman **LaFalce**. Thank you very much. I think there are no further questions at this time and, therefore, the committee stands in adjournment.

[Whereupon, at 12:30 p.m., the committee adjourned, subject to the call of the Chair.]

AVAILABILITY OF DATA ON THE CAUSES OF THE LIABILITY INSURANCE CRISIS

TUESDAY, APRIL 28, 1987

House of Representatives,
Committee on Small Business,
Washington, DC.

The committee met, pursuant to notice, at 9 a.m., in room 2359-A, Rayburn House Office Building, Hon. John J. LaFalce (chairman of the committee) presiding.

Present: Chairman LaFalce; Representatives Cooper, Hayes, Lancaster, McDade, Ireland, Meyers, Combest, Rhodes, and Hefley.

Chairman LaFalce. The Small Business Committee will come to order. Since the end of 1984, thousands of businesses, municipalities, and individuals have been negatively affected by the liability insurance crisis. These groups have had difficulty in finding adequate liability insurance coverage; and when coverage has been obtained, it has often been at several hundred times the previous cost.

These problems regarding availability and affordability of liability insurance led me to hold a series of hearings on the causes of the crisis last year. I believed then, and still believe now, that the first step in determining the cause or causes of the crisis is to get the necessary data.

Some representatives from the insurance industry and the Reagan administration have argued that the cause of the crisis is an increase in tort litigation. Therefore, during the course of my hearings, I continually requested representatives of the insurance industry for data to substantiate its arguments regarding the frequency and severity of tort litigation and the impact on industry profitability.

In particular, I requested information on the industry's actual losses by line and class of business over the past few years, as well as the number of liability claims per year, the number of liability lawsuits, and the number and dollar amount of claims paid, broken down by stage and amount of settlement and verdicts.

However, I have not yet seen this data from the insurance industry. While the industry does collect enormous amounts of data—and indeed, I am advised that the Insurance Services Office Inc., alone has insurance company information that, if stacked end to end, would be equivalent to six and one half times the height of the World Trade Center—it appears that it can produce no data, either to show that there has been a litigation explosion, or to show that any proposed tort reforms would produce sizable benefits to the insurance consumer.

In contrast to the lack of empirical information presented by the insurance industry, expert witnesses from the National Center for State Courts and Jury Verdict Research presented evidence that indicated that there was no explosion in tort litigation.

Indeed, Robert Roper, author of the study conducted by the National Center for State Courts, has stated, "There is not one shred of evidence to indicate there is a litigation explosion in the State court systems," where 95 to 98 percent of tort litigation takes place. Instead, he found that the increase in tort filings has been in line with the increase in population.

It may well be that for some lines and classes of liability insurance, and in some States, the number and size of claims paid has dramatically increased in recent years, which would indicate that noninsurance factors may be, in part, responsible for insurance industry price increases and refusals to provide insurance.

On the other hand, the number and size of claims paid may not have increased dramatically, thus suggesting that it is the insurance industry's own financial and underwriting practices that are a major cause of this crisis.

We need this empirical information before we can determine the appropriate legislative response or responses to this crisis. We have a responsibility to our constituents to ensure that this crisis, which has had such a debilitating impact on them, does not occur again. However, we also have a responsibility not to enact major reforms until we have the empirical basis for such actions.

Today's hearing will focus on these critical problems regarding the availability of insurance data to explain the causes of the liability insurance crisis. We will examine the following issues: (a) the type of data that is needed by and from the insurance industry to determine both the appropriateness of premiums and the relationship between the civil justice system and insurance premiums; (b) whether this data is currently available; (c) if this data is not available, how it can be collected and analyzed; and (d) the appropriate role, if any, for the Federal Government in this data collection gathering effort.

We are very fortunate to have four very distinguished witnesses here today who can speak with authority on these issues: Joseph Delfico, Senior Associate Director of the General Accounting Office; Mavis Walters, senior vice president, Insurance Services Office, Inc., James F. Cerone, consultant, Milliman & Robertson, Inc.; and Jay Angoff, counsel for the National Insurance Consumer Organization.

I would ask all four panelists to come to the witness table at the same time. And I would ask Mr. Delfico if he would be our leadoff witness. And ladies and gentlemen, without objection, I will put the entire text of your remarks in the record at this time, and ask that each of you attempt to summarize your statements in approximately 10 minutes or so, so that we can have adequate time for questioning.

Before we proceed, I wonder if any other members of the committee have any statements that they would like to make.

Mr. **Hayes**. No, Mr. Chairman.

Mr. **Ireland**. No, Mr. Chairman.

Mr. **Rhodes**. No, Mr. Chairman.

Chairman **LaFalce**. Thank you.

Mr. Delfico, please proceed.

TESTIMONY OF JOSEPH F. DELFICO, SENIOR ASSOCIATE DIRECTOR, HUMAN RESOURCES DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY LAURIE EKSTRAND AND SUSAN KLADVIA

Mr. **Delfico**. Mr. Chairman and members of the committee, thank you for inviting GAO to testify concerning how to measure the impact of tort reforms on insurance premiums. With me today are Ms. Laurie Ekstrand, who is my group director and does my insurance work at GAO; and on my left is Susan Kladvia, who has recently completed GAO's work on malpractice insurance.

Since the mid-1970's States have passed a variety of tort reforms intended to accomplish a variety of goals. You have asked us to discuss the feasibility of evaluating whether tort reforms reduce liability insurance premiums, or mitigate their increase, and what data would be needed to relate tort reforms and premiums.

To do the evaluation we need to compare experiences in different jurisdictions. Some States have passed tort reforms and others have not, or have passed them in different time periods. This could provide a basis for comparison that allows an assessment of the impact of reforms. Once we have developed this comparison base, we can identify the data required from insurance companies, State agencies, and other sources.

In general, tort reforms are thought to reduce insurance claim payouts and enhance the predictability of future losses. Given a reduction in losses and greater predictability, insurers should lower premiums.

A necessary condition, then, for tort reforms to lower rates is that they lower insurance claim payouts. If that is shown to be the case, then States with tort reforms should have lower premiums or smaller increases in premiums than States without reforms.

Any approach to making this comparison should be designed to isolate the effects of tort reform on changes in claim payouts and insurance premiums by accounting for other factors that also contribute to changes such as changes in State insurance regulations, market competition, market share of insurance coverage, and socioeconomic characteristics.

It should be capable of dealing with the potential time lag, also between the passage of tort reforms and subsequent effects on losses and premiums.

The remainder of my testimony will focus on measurement issues that we have encountered in our insurance work and their implication for data collection.

One set of considerations involves the tort reforms themselves. Each State passes its own configuration of reforms. Further, not all reforms are likely to affect total claims payouts in the same way. Most reforms are designed to reduce claim settlement amounts and consequently reduce premiums.

A few may increase accessibility to the claims system, thereby increasing the frequency of claims which could result in increasing premiums. The timing of reforms must also be considered. Reforms are passed by States at various times. Within a single State, some reforms may have been adopted one year and others later.

Along the same lines, the implementation of reforms varies. In most States, as tort reforms are passed into law, they apply only to new cases. Since many old cases are likely to remain in the system for several years, the effects of implementation of tort reforms on awards will be spread across many years.

If the effect of the reforms on insurance premiums depends on a record of fewer and smaller awards, their impacts may not be expected to be visible for several years.

Tort reforms are subject to State constitutional challenges and legislative amendment. The recent judicial reversal of the Virginia cap on awards attests to the possibility of reforms being reversed by court actions. As a consequence, this, too, may contribute to delays in the insurance industry's reaction to reforms.

A second set of considerations or factors relates to the States themselves. These other factors could include changes in State regulatory requirements or laws, entrance into the market of new competitors, for changes in the type of insurance sold.

Past research has found that there are other State environmental factors that are related to claim payouts, and thus, may also be related to premiums. Factors that could be considered include urbanization and the number of lawyers per capita.

There are also national level factors that affect premiums, and interest rates are a good example. However, these variables tend to affect changes in premiums nationwide without regard for State boundaries. Their effects on rates are likely to be felt about equally, by both States with and without tort reforms. These national factors can be included in the analysis.

Losses can be measured in terms of claim payouts per year on a State-by-State basis. Of specific interest for the comparison is the change in the paid claim amounts from year-to-year and tort reform and nontort reform States. The first stage of the analysis of the effects of tort reforms on insurance premiums would involve first determining if they have an effect on losses. If losses are not reduced or increased mitigated, the premiums will not be reduced or their increases mitigated.

The wide range of types and amounts of coverage and the diversity of the businesses purchasing insurance makes it difficult to obtain an average premium amount that is comparable State-to-State and year-to-year.

Fortunately, the combination of the insurance loss ratio and the information concerning the reduction in losses obtained in the first stage of the analysis provides an indicator of whether premiums are following the pattern of losses. For the loss ratio to remain stable, given declining losses, the premiums must follow the same pattern of decline.

As indicated in the beginning of my testimony, our basic approach to assessing the effects of tort reforms on insurance premiums is to first compare changes in claim payouts in States with tort reforms to corresponding changes in payouts in States without reforms.

If reforms seem to reduce claim payouts, an examination of the loss ratios should show whether premiums are showing a similar pattern of changes. The analysis will have to be sensitive to potential timelags. To isolate the effects of the reforms from those of other factors that could affect changes in claims and premiums, these other factors must be included in the analysis as well.

Regardless of the level of care in considering other potential reasons for change, there will still be some factors that affect claims and premiums that cannot be accounted for in the analysis. Because of this, the effect of the reforms, if very minor, may not be detectable.

This inability to detect small changes may not be a problem because these changes may not be of the magnitude that would be considered significant in mitigating an insurance affordability crisis or preventing a potential one.

During recent years there have been two waves of tort reforms. The first started in the mid-1970's and dealt with medical malpractice liability. The second started in the mid-1980's and is still going on. This latter set of reforms dealt with, primarily, product and general liability.

The ability to reconstruct the needed data makes measurements of the effects of medical malpractice reforms extremely difficult at this time. In terms of the more recent round of reforms, data that could be collected, currently and into the future, would allow for an assessment of their effects using this type of strategy once a sufficient number of years of data were collected.

In conclusion, I would like to stress that it is possible to develop a workable approach for measuring the effects of tort forms on insurance premiums, but it requires a well planned data collection effort over many years, and this data collection could be a substantial undertaking. As with the development of any methodology, this one would probably require refinements and modification over time.

Mr. Chairman, this concludes my presentation, and I would be glad to answer any questions that you might have at this time.

[Mr. Delfico's prepared statement, with attachments, follows:]

PREPARED STATEMENT OF JOSEPH F. DELFICO, SENIOR ASSOCIATE DIRECTOR, HUMAN RESOURCES DIVISION, GOVERNMENT ACCOUNTING OFFICE

Considerations in Measuring the Relationship Between Tort Reform and Insurance Premiums

Summary

You asked us to consider the feasibility of evaluating whether tort reforms reduce liability insurance premiums or mitigate their increase. After carefully considering possible strategies, and the various factors that complicate the assessment of the relationship, GAO feels that a well designed and executed study could discern the nature of the relationship.

Such a study, however, must be sensitive to the differences in the pattern of adoption and implementation of tort reforms across states, the variation in their potential effects, and the time it will take between initiation of reforms and likely effects on premiums.

Other state and national factors that could also affect insurance premiums must also be considered. These include changes in state regulatory requirements and law, insurance market competition, types of insurance sold, and interest rates and other national economic trends. State socio-economic factors such as urbanization may also be significant.

Tort reforms affect premiums by reducing insurer's losses or claim payouts, or mitigating their increase. Before the effect of tort reforms on premiums can be considered, it is essential to determine if losses were affected.

Data on all of the types of factors that could affect premiums would have to be systematically collected over a period of years to provide the information needed for the analysis.

Mr. Chairman and members of the committee, thank you for inviting GAO to testify concerning how to possibly measure the impact of tort reforms on insurance premiums. Since the mid-1970's states have passed a variety of tort reforms intended to promote the timeliness and equity of tort awards, limit the size of attorney's fees, increase the predictability of claim settlement amounts, and generally enhance the availability and affordability of insurance coverage. You have asked us to discuss the feasibility of evaluating whether tort reforms reduce liability insurance premiums, or mitigate their increase, and if it is feasible, what data would be needed.

To do the evaluation would require comparing experiences in different jurisdictions. The fact that some states have passed tort reforms and others have not, or have passed them during different time periods, provides a basis for comparison that allows an assessment of the impact of reforms.

In general, tort reforms are thought to reduce insurance claim payouts and enhance the predictability of future losses. Given a reduction in losses and greater predictability, insurers should lower premiums. A necessary condition, then, for tort reforms to lower rates is that they lower insurance claim payouts. If that is shown to be the case, then states with tort reforms should have lower premiums, or smaller increases in premiums, that states without reforms.

This seemingly straightforward comparison, however, belies some very difficult measurement considerations that I will discuss shortly. Any approach to making this comparison should be designed to isolate the effects of tort reform on changes in claim payouts and insurance premiums by accounting for the other factors that also could contribute to changes. It should also be capable of dealing with the potential time lag between passage of tort reforms and subsequent effects on losses and premiums. A brief discussion of the factors involved in employing this approach is included as an appendix to this testimony.

The remainder of the testimony focuses on measurement issues that we have encountered in our medical malpractice, commercial general, and products liability insurance work and their implications for data collection to address the issue of the relationship between tort reform and insurance premiums.

TORT REFORMS

One set of measurement considerations involves the tort reforms themselves. Each state passes its own configuration of reforms. Thus, each reform must be considered separately. Further, not all reforms are likely to affect total claims payouts and, hence, insurance premiums in the same way (see appendix B). Most reforms are designed to reduce claim settlement amounts and consequently reduce premiums. A few may increase accessability to the claims system, increasing the frequency of claims, which could result in increasing premiums.

Many reforms are related to specific types of claims, such as medical malpractice or product liability, and therefore affect specific types of insurance. Only those reforms that are likely to affect the specific type of insurance claims and premiums of interest are appropriate for inclusion in the analysis. If several types of tort reform/claim/premium relationships require testing, separate analyses are needed for each type.

The timing of the reforms must also be considered. Reforms were not passed by states at a single point in time, but were passed at various times. Within a single state some reforms were adopted one year and others in a later year. Therefore, the timing of the implementation of reforms varies greatly among and within states.

Along the same lines, the implementation of reforms varies. In most states, as tort reforms are passed into law, they apply only to new cases entering the legal system. Old cases are "grandfathered in" under the old laws. Since cases vary in their length, and many are likely to remain in the system for several years, the effects of the implementation of tort reforms on frequency of awards and their amounts will be spread across as many years. Since the effect of the reforms on insurance premiums may depend on a record of fewer and smaller awards, their impacts may not be reasonably expected to be visible for several years.

Just as other state laws, tort reforms are subject to state constitutional challenges and legislative amendment. Some reforms have built in "sunset" provisions that will abolish them at a given future date. The recent judicial reversal of the Virginia cap on pain and suffering awards attests to the possibility of reforms being rendered ineffective by subsequent court actions. As a consequence, this too may contribute to delays in the insurance industry's reaction to reforms as they wait to determine whether the reforms will withstand challenges.

OTHER STATE AND NATIONAL FACTORS

A second set of considerations relates to the states themselves. All of the other factors that can affect insurance claims and premiums that are unique to each state must be considered and their effects separated from those of the tort reforms. These other factors could include changes in state regulatory requirements or laws, entrance into the market of major new competitors, or changes in the type of insurance sold. In terms of regulatory changes, for instance, a move to a prior approval system for rate increases could affect premiums. The entrance of a large new risk retention group to the market could alter the competitive atmosphere. A shift to predominance of a claims made policy form from an occurrence-based policy market is an example of a change in type of coverage sold that could have a profound effect on both claim payouts and premiums.

Past research has found that there are other state environmental factors that are related to frequency and severity of insurance claims, and thus may also be related to premiums. Factors that could be considered, based on past research results, include urbanization and number of lawyers per capita. Variables such as these could be tested in the analysis to determine if they are needed to better explain the relationship between tort reforms and changes in premiums.

In addition to factors that are unique to each state, there are other factors that affect premiums. Interest rates and general economic trends are good examples. However, these variables tend to affect changes in premiums nationwide without regard for state boundaries. Their effects on rates are likely to be felt about equally by both states with tort reforms and states without the reforms and thus tend to cancel themselves out. These national factors can be included in the analysis.

LOSSES

Claim payouts, or losses, can be measured in terms of the average dollar amount per paid claim, and the number of claims on a state-by-state basis per year. These data are not currently compiled in this fashion across states. Of specific interest for the comparison is the change in the paid claim amounts from year to year in tort reform and non-tort reform states. The first stage of the analysis of the effects of tort reforms on insurance premiums would involve first determining if they have an effect on losses. If losses are not reduced, or increases mitigated, by the reforms, premiums will not be reduced or increases mitigated either.

INSURANCE PREMIUMS

The measure of insurance premiums, themselves, requires careful attention. The wide range of types and amounts of coverage, and the diversity of the businesses purchasing insurance, make it difficult to obtain an "average" premium amount that is comparable state to state and year to year. Fortunately, the combination of the insurance loss ratio (a ratio of premiums received in a year to losses paid and reserves for losses for the same year) and information concerning the reduction in losses (or mitigation of their increase) obtained in the first stage of the analysis provides an indicator of whether premiums are following the pattern of losses. For the loss ratio to remain stable, given declining losses, the premiums must follow the same pattern of decline.

OTHER MEASURMENT CONSIDERATIONS

As indicated in the beginning of the testimony, our basic approach to assessing the effects of tort reforms on insurance premiums is first to compare changes in claim payouts in states with tort reforms to corresponding changes in payouts in states without reforms. If reforms seem to reduce claim payouts, an examination of loss ratios should show whether premiums are showing a similar pattern of change. Because it seems likely that there will be a time lag between the adoption of tort reforms by a state and any effect on claims and premiums, the analysis will have to be sensitive to this potential lag. To isolate the effects of the reforms from those of other factors that could affect changes in claims and premiums, these other factors must be included in the analysis as well. (A list of potential variables for this analysis and potential sources for these data is in appendix C.)

Finally, regardless of the level of care in considering other potential reasons for change, there will still be some factors that affect claims and premiums that cannot be accounted for in the analysis. Because of this, the effect of the reforms, if very minor, may not be detectable. This inability to detect small changes may not be a problem because these changes may not be of the magnitude that would be considered significant in mitigating an insurance affordability crisis, or preventing a potential one. Hence, these minor changes that might be "lost" in the analysis would not have a policy impact in terms of enhancing affordability of liability insurance.

During recent years there have been two waves of tort reforms. The first started in the mid-1970's and dealt with medical malpractice liability. The second started in the mid-1980's and is still ongoing. This latter set of reforms dealt primarily with product and general liability. The ability to reconstruct data concerning actual claim payouts on a state-by-state basis and other non-tort variables that may have affected premiums since the mid 1970s makes measurement of the effects of medical malpractice reforms extremely difficult at this time. In terms of the more recent round of reforms, data that could be collected currently and into the future would allow for an assessment of their effects using the type of strategy once a sufficient number of years of data were collected. However, the type of systematic data collection across insurers, states, and time periods that would be needed would require considerable effort and an extended period of time.

One final note of caution. Some tort reforms cover liability for business activity that is generally intrastate in nature. Medical malpractice is an example. The insurer knows the jurisdiction in which any liability-related injury occurs and may adjust rates to accord with that jurisdiction's tort environment. However, when an insured's products or services cross state lines, tort reforms for any of the states the insured does business in could apply to a claim. For product liability for large manufacturers, for example, the insurer does not know in which jurisdiction an injury is likely to occur. The insurer, then, may take a conservative approach and assess premiums in relation to the less favorable tort environments. The most detectable effects of reforms on insurance premiums may be in lines of insurance or for sizes of businesses that are primarily intrastate.

In conclusion, I would like to stress that it is possible to develop a workable approach for measuring the effects of tort reforms on insurance premiums. We must also point out that the effects of tort reforms on premiums cannot be measured in a single year. Rather, it requires a well-planned data collecton effort over many years. This data collection could be a substantial undertaking. As with the development of any methodology, this one would require refinements in the process of carrying it out. I would be pleased to answer any questions.

APPENDIX A

Factors Involved in Specifying a Regression Model for Measuring the Relationship between State Tort Reforms and Changes in Insurance Premiums

The basic premise of this analysis is that if tort reforms result in a subsequent lowering of premiums or mitigation of their increases, they will do so by reducing or mitigating increases in losses (claim payouts). If tort reforms do not affect losses, they will not affect premiums. The first step in the process, then, is to determine the relationship between state tort reform and losses.

Changes in the amount of insurance losses, or claim payouts, in a state are a function of a set of variables that are unique to each state--a set of background or control variables, and a set of tort reforms or the absence of tort reforms--and year-to-year changes that affect all states.

The first part of the analysis involves constructing a regression equation with changes in losses in each state in each year as the dependent variable. The independent variables include a set of variables at the state level that are likely to influence changes in losses. These could include changes in socio-economic and demographic conditions, such as urbanization, and changes in the type of coverage offered, such as a shift to the claims-made policy form from the occurrance-based form. A second set of state level variables represent the configuration of tort reforms present (or absent) in a state. Additionally, a variable representing year to year changes in those factors that change at the national level is included in the equation.

If this first analysis does not show that tort reforms reduce losses, or mitigate their increase, then they cannot be a factor in reducing premiums or mitigating their increase. If the initial analysis shows that they do reduce losses or mitigate increases, then a further test must be run to examine the relationship between this change in losses and subsequent premiums.

The key to measuring the effect of this tort-induced change in losses on premiums is the loss ratio. This ratio will not change if losses and premiums move in tandem. If, however, losses fall and premiums remain the same or increase, the loss ratio will change. A stable loss ratio, then, given a reduction in losses (or mitigated increases), is the indicator that shows whether tort reforms affect premiums.

Just as with assessing the effects of tort reforms on losses, other factors that could affect premiums must also be considered. These factors could include state regulations such as prior approval of rate increases.

The unit of analysis is a given state in a given year. Dichotomous variables, such as the presence or absence of tort reform, are entered as dummy variables. Because the aspect of the loss ratio of interest is its stability, changes in the loss ratios from year to year would have to be transformed into a measure of stability - how much they diverge from the previous value.

A time lag could be assessed by analysing the relationship between independent variables measured at one time period with the dependent variable measured at a later time period. It seems reasonable to expect that several lag time periods would be tested.

APPENDIX B

This appendix summarizes tort reforms that states have either enacted or proposed and the possible effects of each reform on insurers' payouts and the predictability of risk. The tort reform debate has focused on the indirect effects tort reforms may have on premium rates through their effects on insurers' payouts for damage awards and procedural costs and on the predictability of liability. The general contention is that, by lowering payouts or increasing the ability to accurately predict risk, tort reforms may lower premium rates or mitigate their increase.

Table 2 lists the reforms and indicates their possible impact on payouts and predictability. Definitions of each reform and a rationale for the effects coded in the table are included below.

Tort Reforms and Their Effects on Payouts and Risk Predictability

1. *Ad Damnum Clause* reform legislation prohibits plaintiffs from stating the amount of damages they are attempting to recover in their claims. Such prohibition may decrease payouts by removing any influence large demands may have on jurors making awards greater than that indicated by the evidence presented at the trial.

2. *Alternative Dispute Resolution Procedures* include expedited procedures such as pre-filing negotiations or arbitration in place of a jury trial. These procedures may be optional or required and are designed to decrease litigation costs. However, they could also increase access to the system and thus increase claim frequency.

3. *Restrictions on Attorneys' Contingency Fees* would limit fees that could be collected by plaintiff attorneys either to a percentage of the award less than the current typical fee of one-third; a sliding percentage scale where percentages would decrease with additional increments in awards; or, for large awards, fees that appear reasonable as determined by judicial review. Attorney fee restrictions may lower awards and procedural costs by mitigating juries "padding" of awards to help cover fees and by discouraging plaintiff attorneys from either filing suit or taking to trial high-risk award pain and suffering cases that could otherwise be settled.

4. *Caps on Awards* include provisions limiting entire awards or just non-economic damages to a fixed value or an amount based on life expectancy, injury severity, or actual economic damages. Caps are designed to lower awards by eliminating "excessive" awards and to increase risk predictability by limiting the range of awards.

5. Collateral Source reforms would eliminate the collateral source rule, which prohibits the introduction of evidence regarding payments for the same injury from another source, and/or would require that verdict awards be reduced by amounts paid by collateral sources. Collateral source reforms are often accompanied by provisions restricting collateral source reinbursement through subrogation liens. These reforms would decrease award amounts and, thus, payouts by virtue of deductions for payments by other sources. To the extent incentives for safety are mitigated by guilty parties not paying for all damages, decreases on awards may be offset by increased safety risks and increases in the number of claims. Collateral source reforms coupled with subrogation restrictions may simply transfer payments to other sources and require them to raise their premiums or costs as a consequence.

6. Modifications of the Comparative Negligence Rule would eliminate pure comparative negligence, in which awards are reduced in proportion to the injured parties fault, in favor of a modified rule. Modified rules would still reduce awards by the proportion of plaintiff's fault but would also bar collection of any award if plaintiff's proportion of fault were to exceed a certain level. Comparative negligence reforms are designed to enhance predictability by increasing the extent to which damages paid are based upon defendants proportion of fault. By eliminating any award in certain circumstances, these reforms may also reduce total payouts relative to pure comparative negligence.

7. Establishing Compensation Funds provides alternative mechanisms for compensating victims other than litigation and payment by liable parties. Such funds could compensate victims when defendants do not have the financial resources to cover damages, decrease the financial burden on insurers, and bypass costly litigation. To the extent liable parties do not have to pay for damages, establishing compensation funds may remove some deterrence for disregarding safety and may increase the number of claims,

8. Expert Witnesses reforms pertain to the qualifications and use of expert witnesses, such as requiring their testimony in order for a plaintiff to prevail in suits based on negligence.

9. Fault-Based Liability Standards reforms would require courts to use fault-based standards of negligence or foreseeability in determining liability. Fault-based standards' primary effect would be to increase risk predictability, since liability would be based on specified misconduct and safety criteria.

10. Frivolous Suit reforms attempt to eliminate the filing and/or processing of suits that lack either any redeeming legal merit or a serious basis for believing the defendant is liable. These reforms may implement sanctions such as awarding litigation costs and/or procedures designed to insure the merits of a case

at filing. Eliminating frivolous suits and/or their processing would decrease payouts for defense costs and court processing and increase the predictability of lawsuits alleging liability.

11. Grants of Immunity from Prosecution would limit the circumstances in which lawsuits could be filed against specific groups such as product sellers and municipalities. These reforms are designed to decrease payouts by reducing the number of claims filed against parties who are often only minimally liable.

12. Itemized Jury Verdicts would require juries to breakdown awards into amounts for specific damages, such as economic damages, pain and suffering, etc. These reforms have no obvious effects on payouts and liability risks, but coupled with judicial review, may eliminate any exceeses in awards for specific damages.

13. Limits on Joint and Several Liability would restrict circumstances in which each of two or more defendants would be liable for paying all plaintiff's damages to economic damages or to cases in which there was concerted action. Joint and several liability reforms would reduce overall payouts of awards and increase risk predictability by (1) tieing payments more closely to defendants' share of fault and (2) decreasing incentives for suing defendants with financial resources when they are only minimally responsible.

14. Limitations on Prejudgment Interest either eliminates juries' option of requiring defendants to pay interest on all or part of the award or put limits on the damages and/or time periods after filing for which interest can be paid. These reforms are designed to remove any incentives prejudgment interest may have on plaintiffs not settling before jury trial and may ultimately decrease payouts for awards.

15. Reforms Concerning Punitive Damages, which are damages intended to punish defendants, include a variety of reforms, such as provisions limiting their amount, raising the standards of misconduct and evidence required for their award, and prohibiting their request until after an initial finding of liability. These reforms may lower punitive damage awards and their amounts, which tend to be large. These provisions are primarily designed to increase predictability by limiting punitives to the deliberate and malicious disregard for the interest of others.

16. Statutes of Limitations and Repose include provisions requiring suits to be filed within a time period either following the injury, when a reasonable person would have known about the harm and its cause, or sale/delivery of the product/service. Statutes of repose may place a higher burden of proof on the plaintiff to show the product/service was unreasonably dangerous, for which gathering evidence may become more difficult with the passage of time. These statutes are designed to increase

insurance companies and manufacturers' abilities to accurately predict risk by eliminating long tail claims distributions.

17. Structured Settlements allow or require courts to convert awards from a lump-sum payment for large awards (e.g., over $100,000) or future economic losses to periodic payments. The defendant may pay interest, which is estimated for the period of the plaintiff's disability or life. Periodic payments are designed to decrease the burden of large, lump-sum payments on defendants, make payouts more predictable, help assure funds are available for the intended purpose, and eliminate any windfalls to beneficiaries in the event the injured party dies.

Table 1: **Hypothesized Effects of Tort Reforms. A "plus" denotes a reduction in payouts, or an increase in predictability.**

Reform	Payouts	Risk Predictability
1. Ad Damnum Clause	-	
2. Alternative Procedures	-	
3. Attorneys' Fees	-	
4. Caps on Awards	-	+
5. Collateral Source	+/-	
6. Comparative Negligence	-	+
7. Compensation Funds	+/-	
8. Expert Witnesses		
9. Fault-Based Liability		+
10. Frivolous Suits	-	+
11. Immunity from Prosecution	-	
12. Itemized Jury Verdicts		
13. Joint and Several Liability	-	+
14. Prejudgment Interest	-	
15. Punitive Damages	-	+
16. Statutes of Limitations/Repose	-	+
17. Structured Settlements	-	

Appendix C

Variables and Sources of Data

Dependent Variables:

- A measure of stability of loss ratio from year to year, by state.
- Change in claim payouts from year to year by state.

  Data needed:

    Loss ratios by line by state for each year for a series of years.

    Claim payouts by line by state for each year in a series of years.

Source:

Insurance companies and other insurers such as risk retention groups.

Explanatory Variables:

- Tort reforms by type (the number of tort reforms may make grouping them together for the purpose of classification a reasonable strategy. For example, all reforms instituting caps on non-economic awards may be considered as one reform regardless of differing levels of caps. Or, alternatively, they could be classified into two groups-high cap and low cap-based on size of the cap).

  Data needed:

    Presence or absence of each type of tort reform in each state in each year in a series of years.

  Source:

    State attorneys general offices

- Changes in state insurance regulations, by type (i.e. prior approval of rate changes).

Data Needed:

Presence or absence of a set of state regulatory provisions in each state for each year in a series of years.

Source:

State insurance commissions

- Changes in market competition

(i.e. the entrance of a state-sponsored insurance fund)

Data needed:

Presence of absence of major new sources of insurance in each state for each year in a series of years.

Source:

State insurance commissions

- Change in market share of the form of insurance coverage (i.e. shift from occurrence based coverage to claims-made coverage).

Data needed:

Presence or absence of a major change in form of insurance predominant in the market.

Source:

State insurance commissions

- State socio-economic characteristics (i.e. urbanization, attorneys per capita).

Data needed:

Percent possessing the characteristic for each state for each year in a series of years.

Source:

Published sources such as the Current Population Survey

- Year (i.e. 1984, 1985, 1986, etc.)

Data needed:

Each year in the series covered by the analysis.

Source:

Enumeration of the years over which data were collected.

Chairman **LaFalce**. We will have a few questions for you, but we will defer those until we have heard from the other members of the panel, Mr. Delfico. Ms. Walters.

TESTIMONY OF MAVIS A. WALTERS, SENIOR VICE PRESIDENT, INSURANCE SERVICES OFFICE, INC. [ISO]

Ms. **Walters**. Thank you, Mr. Chairman. I am Mavis Walters, senior vice president of the Insurance Services Office. I am a fellow of the Casualty Actuarial Society and a member of the American Academy of Actuaries.

As you know, Mr. Chairman, ISO is a national, voluntary, not for profit corporation that makes available advisory rating, statistical, actuarial, policy form, and related services to any U.S. property-casualty insurer. We are a voluntary association, and we have no mandatory membership requirements nor do we have adherence requirements with respect to our products and services.

The subject of this hearing today, of course, is insurance data. I think that it is important that we all recognize that all insurance data comes from the same source which are the daily business transactions conducted by insurance companies.

To obtain the most useful information and to maximize the efficiency of collecting it, current data reporting requirements reflect well-defined objectives and carefully designed specifications.

Insurance data are frequently categorized into two broad areas, financial data and statistical data. Financial data are reported in the annual statements filed by insurers with State regulatory authorities to assist those State regulatory authorities in measuring the overall solvency and profitability of insurance companies.

This annual statement, which is essentially a financial document, provides a uniform data reporting format, and it is required in all States in which an insurer is licensed. This document provides detailed financial information about the assets and liabilities including data on premiums, losses, reserves, expenses, dividends, and investments. It encompasses 32 lines of business.

Compilations and analyses of insurance annual statement data are provided by the A.M. Best Co., and these are widely used in analyses of industry profitability whether done by the private sector, by insurers, or others.

Statistical data, by contrast, contain fundamental detailed information about specific insurance coverages and the premium and loss experience related to those specific coverages. This statistical information is required so that regulators can monitor whether or not the statutory requirements in each State are being fulfilled. Those statutory requirements are that rates shall not be excessive, inadequate, or unfairly discriminatory.

But statistical information is collected in all States regardless of whether the insurance rates for the State are subject to prior approval or whether the State is a so-called open competition State.

In most cases, the State regulatory agencies designate statistical agents to collect and compile this required statistical data. These statistical agents develop detailed instruction books which we call statistical plans which specify the way that each insurer is to code and submit its premium and loss data to the statistical agent. ISO is one of those stat agents.

To meet statutory demands, we provide data in the complete detail of approved coverage forms and rating structures for each line of insurance. For general liability alone, that is, one of the annual statement lines of business, ISO collects premium and loss data for over 1,100 separate classes in each State.

Occasionally, however, issues of interest to both insurers and policymakers make it desirable to supplement the routinely available financial and statistical data that are provided as a matter of course.

In the past, for example, back in the days that States were turning to no-fault insurance, we had special claim studies of private passenger automobile liability insurance in order to examine the efficiencies of no-fault systems. We have had claim studies in the medical malpractice and product liability insurance areas as well.

Special claim studies can be helpful in answering specific questions. However, even in a well-designed claim study, inherent limitations exist with respect to the availability and use of such information. Indeed, these limitations may inhibit the precise quantification of any results of such a study.

But with full recognition of the potential limitations that claims studies present, ISO is sponsoring now, two high priority projects involving commercial insurance claims data. These two projects combined, will obtain as much objective information as possible about the relative impact on claim costs of various tort reforms.

These studies will assist insurers, regulators, and others in making the difficult judgments that are associated with evaluating the effects of tort reform. That is not an easy job, and I am sure that we will get into that a little bit later.

In addition, these studies will help to gather all available information from insurer claim files that will be valuable in assessing future changes or modifications in existing tort law.

The first project, the claim evaluation project, was conducted by the independent policy and management consulting firm of Hamilton, Robinovitz & Alschuler of Los Angeles. This project required a group of experienced claims staff to evaluate certain typical but hypothetical claims, first under current tort conditions, and then under so-called reform tort laws.

The final reports for this claim evaluation project, we hope, will be available by the end of next month, no later than the end of next month.

The first one was a relatively short-term study. The second project that we are involved in is the claim file data analysis study. This is going to be performed by ISO staff internally and our participating insurers.

This project will collect key data from actual claim files in selected States to provide an estimate of the value of the claims in the new tort environment, and to allow us to collect additional data that could be used by insurers in their individual evaluations of the effect of various other tort reform measures on claim costs.

The claim file data analysis, the second study that ISO is doing, contemplates a review of at least 12,000 claims—6,000 claims with a value estimated to be greater than $25,000, and 6,000 with a value of under $25,000. And it will involve a mixture of both open and closed claims.

The project will examine claims greater than $25,000 arising out of policy year 1983 and closed after July 1, 1985, or currently open. And to make sure that those open claims are reasonably mature and that we know something about them, we will require that those claims are open on or before January 1, 1986.

To the extent that insurer claim files contain sufficient information on any of the enacted tort reforms, the study will consider among other things limiting noneconomic damages, restricting or eliminating punitive damages, restricting or eliminating the collateral source rule, and restricting or eliminating the doctrine of joint or several liability.

Among the matters that the study will examine are the amount of the claim, the cause of the claimant's injury, the type of claim, whether it is closed or open, the economic impact to the claimant, such as wage loss, to the extent that we can determine it, the existence of collateral sources to the extent that the information is available, the allocated loss adjustment expenses which are the expenses of investigating and defending claims, as well as the amount of any punitive damages if it can be found.

In response to many legislative and regulatory inquiries concerning the experience of commercial liability classes, ISO compared a compendium of countrywide statistical plan data focusing on the troubled classes that we hear about most frequently, municipalities, of other government subdivisions, liquor liability, and daycare centers.

A copy of this document, containing the data, has been provided to the staff, and we did have 10 copies which we sent up yesterday. This document provides data that was available at the end of last year. We are hoping to have an updated year very shortly, and we certainly will provide that information when it comes in.

Finally, in concluding, whenever we are looking at the problems of availability and affordability, I think that a lot of us are left wishing that we had more information than we have. However, I think that it is instructive to recognize that the growth in paid losses, paid losses from the insurance industry, has far exceeded this country's economic growth as we traditionally measure it by GNP, by gross national product.

And in fact, that growth in paid losses has been variable by line of business, and let me be specific. From 1979 to 1985, gross national product as a measure of economic growth in our country grew by 59 percent. During the same period, property casualty written premiums grew 68 percent, a little higher, a little better than gross national product. But paid losses grew by 100 percent, greater than the overall economic growth.

But what is even more interesting is when we examine that loss growth by line of insurance, we see different patterns. For example, in commercial lines, paid losses grew 117 percent in those 6 years. Commercial liability paid losses grew 179 percent. Now remember that GNP was growing 59 percent. Commercial liability paid losses increased 179 percent.

But worst of all, for general liability and medical malpractice combined, paid loss costs grew 234 percent during the 6-year period. That is at an annual rate of 22 percent while GNP was growing at the rate of only 8 percent.

We cannot answer the question as to why this happened. But to me, this is clearly an indicator that something was happening in our external environment that was having a disproportionate impact on paid losses for various lines of insurance.

I am not going to try to answer the question why, but I think that the evidence strongly suggests that there were external societal, economic, technical, judicial, and legal factors which influenced that variation in paid-loss growth.

That completes my formal testimony, Mr. Chairman.

[Ms. Walters' prepared statement, with attachment, follows:]

PREPARED STATEMENT OF MAVIS A. WALTERS, SENIOR VICE PRESIDENT, INSURANCE SERVICES OFFICE, INC. [ISO]

I am Mavis A. Walters, Senior Vice President Insurance Services Office, Inc. I am a Fellow of the Casualty Actuarial Society and a Member of the American Academy of Actuaries. I am currently a Vice President of the AAA and serve as an elected member of the Board of Directors of the CAS.

Insurance Services Office (ISO) is a national, voluntary association of property and casualty insurance companies, organized as a not-for-profit corporation. ISO makes available advisory rating, statistical, actuarial, policy form and related services to any U.S. property-casualty insurer. ISO has no mandatory membership requirements nor do we have adherence requirements with respect to any of our products and services.

ISO functions to a varying extent in all fifty states, the District of Columbia and Puerto Rico. Typically we are licensed as an advisory organization and/or a rating or rate service organization and we serve as an authorized statistical agent on behalf of state regulatory authorities.

DATA SOURCES

All insurance data come from the same source: the daily business transactions conducted by insurance companies. These transactions result in information being compiled which provides a basis for evaluating solvency, estimating profitability or measuring the relationships between rates and coverages.

To obtain the most useful information - and maximize the efficiency of collecting it - current data reporting requirements reflect well-defined objectives and carefully designed specifications. In spite of the different programs and procedures of literally hundreds of insurance companies, these reporting requirements apply uniformly, allowing the data to be consolidated for analysis. And they are sufficiently comprehensive to allow for detailed analyses by accountants, actuaries, economists, regulators, statisticians, securities analysts, stockholders, underwriters, and others.

Financial data are reported in the Annual Statement filed by insurers with state regulatory authorities to assist them in measuring the overall solvency and profitability of insurance companies.

Insurance financial data focus on quarterly or annual performance. They are useful only as a one-time "snap shot" view of a financial picture that is both larger in scope and longer in duration. To achieve insurance financial data's basic objectives - measuring solvency and profitability - such data must account for the long-term liabilities assumed by insurance companies as part of their unique risk-taking function. The methods for doing so are prescribed by law and regulation and are known collectively as "statutory accounting principles".

The Annual Statement provides a uniform data reporting format and is required in all states in which an insurer is licensed. This document provides detailed information about assets and liabilities including data on premiums, losses, reserves, expenses, dividends, and investments. It encompasses thirty-two lines of business, including the major commercial lines of insurance such as Fire, Allied Lines, Commercial Multiple Peril, Medical Malpractice, Other Liability (General Liability) etc. When possible, Annual Statement financial data are separately identified by line of business, by state or both.

Compilations, reports and analyses of insurer annual statement data are provided by the A.M. Best company, and these are widely used in analyses of industrywide profitability.

Statistical data, by contrast, contain fundamental detailed information about specific insurance coverages and the premium and loss experience related to those coverages. This statistical information is required so regulators can monitor the statutory requirements that rates shall not be excessive, inadequate or unfairly discriminatory.

Therefore, the laws in most states require that insurers provide statistical information at least annually in the form and detail that is necessary to aid the regulator in determining whether the rating systems comply with the statutory standards. Statistical data are collected in all states, regardless of whether insurance rates for those states are introduced with the prior approval of the regulator or are implemented by the company, subject to later regulatory review.

In most cases state regulatory agencies designate statistical agents to collect and compile this required statistical data in a level of detail to permit the evaluation of an existing rate structure and its component parts, such as class, territory and coverage. The statistical agents develop detailed instruction books, called statistical plans, which specify the way each insurer is to code and submit its premium and loss data to the statistical agent. The statistical plans define the data elements (e.g., line of business, coverage, class, state, territory, premium, etc.) as well as the formats and time-frames for company reporting, thus permitting the compilation of aggregate data in a uniform manner. The plans are continually reviewed by the statistical agents and are modified, subject to review and approval by individual states, to correspond to approved rating structures and coverage programs.

Statistical plans are subject to review and approval by individual states. Moreover, the statistical agents are subject to regulatory examination to assure that they are performing in accordance with regulatory standards.

ISO is one of the major statistical agents. Companies reporting to Insurance Services Office represent approximately 80% of the market for the commercial lines of insurance that ISO services.

Each of ISO's reporting companies submits relevant information about individual commercial lines policies. Consistent with the purpose of statistical plans, the reported data vary for each commercial line of insurance. However, the data generally include elements necessary for a thorough evaluation of the rate structure for a given state, line, and class of business.

Data under the ISO statistical plans are collected on a unit transaction basis. That is, a record is coded and reported to ISO every time a policy is issued, a loss is paid, or a case reserve is established or revised. In addition to the premium dollars, the record captures substantial information about the risk's characteristics, such as the line of business (e.g., general liability, products and completed operations), the classification (e.g., dairy products manufacturing), the coverages (e.g., bodily injury, property damage), the exposure (e.g., units of area, receipts, or sales), the location (e.g., state and territory), policy limits and deductible.

Similar reporting is required on the loss side. A loss record is generated every time a loss is paid or a case reserve is established or changed. Total loss dollars are reported separately for paid losses and outstanding losses. In addition to the risk characteristics reported on the premium record - line, class, coverage, state - information such as "type of loss" and "claim count" is also collected. ISO processes over 800 million records annually, and, at any one time, the size of its data base exceeds 1.7 billion records.

To meet statutory demands, ISO provides data in the complete detail of approved coverage forms and rating structures for each line of insurance. For general liability insurance alone, ISO collects premium and loss data for over 1,100 separate classes in each state. These classes range from day care centers to grocery stores to paper manufacturers. To the extent that these classifications generate enough data for a credible analysis the data can be used to review historic rate level adequacy for each class or as the basis for prospective rate levels.

A comprehensive data quality program is an integral part of the data processing function at ISO. Any data errors detected during processing are returned to the companies, which are then responsible for correcting the errors and resubmitting the data to ISO. This is not a selective process - it applies to every company and every submission without exception.

Once the statistical data have been verified as valid, reliable, and accurate, they are reported to regulators to assist them in determining whether existing rate systems are in compliance with the insurance statutes of their states. the NAIC Statistical Handbook specifies the statistical reports that regulators receive.

CLAIM FILE INFORMATION

Occasionally, issues of interest to both insurers and policymakers have made it desirable to supplement the financial and statistical data that are routinely provided. For example, claim studies of private passenger automobile liability insurance were conducted to examine the potential efficiencies of a no-fault system of compensation. Claim studies have also been used to analyze problems in medical malpractice and product liability insurance.

Claim studies can be helpful in answering specific questions.

However, even in a well-designed claim study, inherent limitations exist with respect to the availability and use of information, and these limitations may inhibit the precise quantification of results.

With full recognition of the potential limitations that claim studies present, ISO is sponsoring two high-priority projects involving commercial insurance claims data. Using the services of a respected policy and management consulting firm, as well as ISO's own statistical and actuarial expertise, the two projects will efficiently provide valuable, focused claim data to:

> obtain as much objective information as possible about the relative impact on claim costs of various tort reforms;
>
> assist insurers, regulators and others in making the difficult judgments associated with evaluating the effects of tort reform; and
>
> gather all available information from insurer claim files that will be valuable in assessing future changes or modifications to existing tort law.

By their very nature, these projects cannot provide all the information needed to precisely measure tort reform. Therefore, informed judgement will remain a key ingredient in any evaluation of the effects of various tort reforms.

The first project - the Claim Evaluation Project was conducted by the independent policy and management consulting firm of Hamilton, Rabinovitz and Alschuler of Los Angeles, California. The Claim Evaluation Project required a group of representative, experienced, claims staff to evaluate certain typical but hypothetical claims, first, under current, and then, under "reformed" tort laws. In effect, each claim examiner evaluated the identical set of typical claims.

Fifteen states that have enacted tort reform and nine states that have not enacted tort reform, or that have enacted tort reform with more limited applicability were selected for a representative evaluation. Their selection was based on a combination of criteria, including geographic region of the country, population, existing tort law, the purity of the reforms enacted and the mix of the reforms enacted.

The final reports for the Claim Evaluation Project should be available by the end of next month.

The second project, the Claim File Data Analysis will be performed by ISO and participating insurers, with the results compiled by ISO. The project will collect key data from actual claim files in selected states that have enacted some modification of the tort system. Not only is the project designed to provide an estimate of the value of the claims in the new tort environment, but the project will collect additional data that could be used by insurers in their individual evaluation of the effect of various other tort reform measures on claim costs.

The actual technical specifications of the project have been reviewed with representatives of the National Association of Insurance Commissioners (NAIC). The NAIC was invited to participate and suggest appropriate adjustments, where necessary, to ensure that the project provides useful information to regulators and other government interests.

The design of the Claim File Data analysis contemplates a review of at least 12,000 claims - 6,000 claims, each with a total claim value estimated to be greater than $25,000, and 6,000 claims, each with a value less than $25,000. Recognizing the possible limitations of claim studies, ISO has attempted to minimize those limitations by a project design that includes a mixture of open and closed claims, and a balance of maturity and freshness.

The criteria for selecting claims are as follows:

> Claims over $25,000 - A reasonable balance between currency of data and maturity of claims is essential for this body of claims. For this reason, the options of looking solely at closed claims (too stale) or open claims (too immature) were

rejected. Therefore, the project will examine claims greater than $25,000 arising out of policy year 1983, closed after July 1, 1985 or currently open. To assure a reasonable degree of maturity of claim file data on currently open claims, it is required that the claims were open on or before January 1, 1986.

All claims sizes - A target sample of 200 claims per state will be extracted from claims, regardless of policy year and regardless of size of claim, closed during the month of May 1987.

Government Claims - All governmental claims from policy year 1983, open or closed, regardless of size, will be selected.

The Claim File Data Analysis will study the bodily injury liability portions of Owners, Landlords & Tenants, Manufacturers and Contractors, Product Liability, Commercial Auto, and Businessowners insurance. To the extent insurer claim files contain sufficient information on any of the enacted tort reforms, the study will consider, among other reforms:

- limiting non-economic damages;

- restricting or eliminating punitive damages;

- restricting or eliminating the collateral source rules; and

- restricting or eliminating the doctrine of "joint and several" liability.

Among the matters the study will examine are the amount of the claim, the cause of the claimant's injury (such as defective product sold by the insured), the type of claim (closed or open), the economic impact to the claimant (such as wage loss), the existence of collateral sources (such as Medicare), the allocated loss adjustment expense (such as the cost of defending against the claim), and the amount of any punitive damages.

About twenty-four insurers will participate. They will represent almost 80% of the countrywide general liability insurance premiums written. While no insurer will participate in all of the 27 states selected, the insurers participating in each state collectively will represent at least 50% of the general liability premiums written in that state.

Underwriting Results: by Individual Classifications

In response to many legislative and regulatory inquiries regarding certain commercial liability classes, ISO prepared a compendium of countrywide statistical plan data focusing on municipalities, other governmental subdivisions, liquor liability and day care centers. These exhibits display the total limits earned premium, incurred losses, number of incurred claims and loss and loss adjustment ratio for each of these classes for each of the five policy years ending with December 31, 1984. A copy of the document containing this data has been provided to the subcommittee staff. A one page summary exhibit for four of these classes is attached to this testimony. We should note however, that much of this business is written by insurers not reporting to ISO or under programs that do not permit the capturing of detailed information. We hope to have a later year of data, i.e. for the policy year ending December 31, 1985 within the next couple of weeks. When the later year of data becomes available we will be pleased to submit updated exhibits to this committee.

Finally, in looking at the problems of affordability and availability, it may be helpful to recognize that the growth in paid losses has far exceeded this country's economic growth, as measured by GNP and has shown significant variation by line of business.

From 1979 to 1985, the GNP grew 59%. During the same period, total property-casualty written premium increased 68%. However, paid loss growth exceeded the nation's overall growth by an even larger margin, increasing 100%.

The difference between loss growth and the nation's GNP growth was concentrated in commercial lines, where losses grew 117% in six years.

The problem has been further concentrated in commercial liability (where paid claim costs grew 179%) and particularly general liability (including medical professional), where paid claim costs grew 234%, during the six year period.

For general liability and medical professional, paid losses grew at an annual rate of 22%, while GNP grew at an 8% rate, for a 14 point annual gap.

Clearly, something more than simply inflationary elements has been influencing insurance claim costs over the past six years.

General Liability Insurance

Countrywide Experience for Monoline and Package Business

Classes	Policy Year Ending	Earned Premiums	Developed Incurred Losses*	Exposures	Number of Claims	Pure Premium**	Loss Ratio***
Streets and Roads	1980	6,874,941	15,204,974	714,028	1,307	21.29	2.212
	1981	7,538,187	23,037,302	837,237	1,654	27.52	3.056
	1982	7,328,564	31,128,480	916,723	1,818	33.96	4,248
	1983	6,660,170	34,185,249	874,060	1,921	39.11	5.133
	1984	5,652,493	30,654,208	801,280	1,868	38.26	5.423
	Total	34,054,355	134,210,213	4,143,328	8,568	32.39	3.941
Average Annual Change		-5.0%	19.7%	2.8%	9.0%	16.5%	—
Public Schools	1980	12,240,630	14,792,829	9,356,173	1,918	1.58	1.209
	1981	16,029,374	21,756,039	11,269,124	2,549	1.93	1.357
	1982	17,193,101	25,280,645	10,724,966	2,920	2.36	1.470
	1983	23,965,987	58,021,060	12,954,950	4,680	4.48	2.421
	1984	21,776,520	61,433,435	12,192,411	4,884	5.04	2.821
	Total	91,205,612	181,284,008	56,497,624	16,951	3.21	1.988
Average Annual Change		16.8%	46.6%	6.9%	28.1%	37.2%	—
Governmental Subdivisions	1981	13,966,938	14,954,029	8,835,823	886	1.69	1.071
	1982	26,561,019	29,504,937	21,875,621	2,236	1.35	1.111
	1983	29,064,201	41,899,350	19,983,796	3,079	2.10	1.442
	1984	25,970,257	56,169,028	20,851,563	3,627	2.69	2.163
	Total	95,562,415	142,527,344	71,546,803	9,828	1.99	1.491
Average Annual Change		21.5%	54.0%	28.2%	57.6%	20.1%	—
Day Nurseries	1980	1,785,529	1,282,085	241,710	254	5.30	0.718
	1981	2,581,645	2,338,217	303,959	336	7.69	0.906
	1982	3,321,139	3,623,899	367,181	462	9.87	1.091
	1983	4,016,915	5,504,677	404,479	612	13.61	1.370
	1984	4,586,601	7,783,654	457,412	840	17.02	1.697
	Total	16,291,829	20,532,532	1,774,741	2,504	11.57	1.260
Average Annual Change		26.3%	56.3%	16.9%	34.9%	33.7%	—

[illegible]

***Loss Ratio - Losses Earned Premiums

Chairman LaFalce. Thank you, Ms. Walters. We, too, will have some questions for you at the conclusion of the panel.

Our next witness will be Mr. James Cerone.

TESTIMONY OF JAMES F. CERONE, CONSULTANT, MILLIMAN & ROBERTSON, INC., ACCOMPANIED BY ALLAN KAUFMAN, CASUALTY ACTUARY

Mr. Cerone. Good morning, Mr. Chairman and members of the committee. My name is James F. Cerone, and I am a consultant with Milliman & Robertson, Inc. [M&R], one of the Nation's largest actuarial and management consulting firms.

Our clients include businesses and organizations who self-insure, insurance companies, and regulators. We provide independent services and opinions to assist clients in the formation of self-insurance mechanisms; in valuations of insurance companies for purposes of mergers, acquisitions and liquidations; and general consulting services directed toward the management of organizations.

My practice area concentrates on the operation and management of property and casualty claims. My professional experience includes 25 years as an employee and senior executive with several insurers where I served in virtually all claim department positions from adjuster to chief claims officer. I have worked as a claims management consultant since the start of 1982. Prior to joining M&R, I was a vice president and consultant with Tillinghast Nelson & Warren, Inc., and Kramer Capital Consultants, Inc.

With me this morning is Mr. Allan Kaufman. Mr. Kaufman is a casualty actuary at M&R. He has devoted significant time to the study of tort reform and its impact on insurance rates in projects for the American Medical Association, various State medical societies, and a number of State tort reform coalitions.

We are pleased to have been invited here to provide, approximately, 10 minutes of testimony regarding the committee's agenda item, Availability of Insurance Data To Explain the Causes of the Liability Insurance Crisis. My perspective is that of a claims specialist, and Mr. Kaufman's view is that of a casualty actuary.

Following my testimony, both of us will be pleased to answer questions.

My testimony is directed toward the issues defined by the committee. The comments and opinions I make are mine and not necessarily those of M&R.

The first issue is the type of insurance data needed to determine the relationship between the civil justice system and insurance premiums.

The U.S. insurance market is huge with annual premiums in excess of $125 billion and the number of insurers in excess of 2,500. Loss and loss expenses exceed $80 billion annually. Within the array of insurers, there are primary insurers, excess insurers, and reinsurers. The insurers maintain exhaustive records to serve both internal and external reporting needs.

In addition to loss and premium data bases, additional loss information is contained in millions of open and closed claim files. Another segment of the market are those businesses that self-insure, and it is estimated that they displace approximately another 25 percent of the commercial line insurance market in the United States

In view of this, anyone seeking data for purposes of performing a meaningful analysis should carefully define the issue to be examined and then be specific in formulating a request for data. To do otherwise would produce an avalanche of information, both inefficient and expensive. And remember that the data is not consistently recorded by all companies.

Here are some suggestions and issues to consider in beginning to define data needs concerning the civil justice system and insurance premiums.

With respect to premiums, the area of relevance can be limited to charges for liability coverages under both personal and commercial policies. Premium information should probably exclude intercompany reinsurance premiums and focus on the gross-earned premiums of primary and excess insurers, that is, the price paid by policy holders for liability insurance.

The civil justice system is a broad and ambiguous term that needs definition for purposes of defining data needs. In your context, I would interpret this to be the sums paid by insurers for the disposition of all liability losses and related expenses for adjusting and legal services.

In both premium and loss definitions, a further indicated refinement is to focus the analysis and data needs on bodily injury matters only. This suggestion is made since, as compared to property damage claims, bodily injury claims are far more volatile and involve the issues of noneconomic damages. In choosing this course, the analysis must include consideration of the fact that total premiums cannot be fully segregated to bodily injury coverages. Loss data can be, mostly, obtained for bodily injury claims only.

The preceding is a brief suggestion to define data needs. Unfortunately, a request limited to all bodily injury loss, loss expense, and premium data will, on one hand, still produce a flood of unmanageable data, and, conversely, not provide the critical information contained in the claim files. What must be done, in my judgment, is to clearly define and precisely articulate what it is that you seek to know.

Certainly there is a direct correlation between losses and premiums. But there are a variety of other factors that affect the price of insurance such as insurer capacity, investment yields, internal marketing strategies, general economic conditions, peripheral market conditions, and insurer competition. Insurance premiums are not, simply, a loss plus pricing decision.

It is also true that the civil justice system influences loss costs. Just as factors other than losses affect premiums, there are many external factors which affect loss levels. The prime question for losses, however, is to define what is perceived to be a direct civil justice system cause for the liability crisis. Is it the size of jury verdicts? Is it related to comparative or contributory negligence laws, or both? Is it contingency fees? Is it punitive damages? Is it joint and several liability? The list goes on.

Short of replacing trial by jury with some form of scheduled benefits program, the basic question of what precisely is wrong with the civil justice system must be defined and tested. Unless this is carefully done, both buyers and sellers of insurance may find themselves with a remedy they neither needed nor like.

In sum, the type of data needed cannot be efficiently defined until the issues are clear and a study methodology designed to examine those issues.

The second question is the data availability. Data is available from two basic sources in two forms. Electronic data bases of insurers and statistical rating vendors contain historical information on premiums and losses. Presumably, this data source can provide various distributions and sorts, related to a specific issue, for purposes of analysis.

Claim files represent a second source of information. Claim file information is in the form of paper documents and investigative materials. This information is not electronically or magnetically stored and can only be obtained by a hands on review of the files.

Extracting claim file data is a time consuming and expensive project. For this reason, it is critical to be specific in selecting the files to be reviewed and in designing an efficient file review format. It is unlikely that a study, as discussed today, could be performed without information from both data sources.

Another related issue is the choice between ongoing data collection versus one-time requests. It seems clear that this issue requires a one-time request of data and review of files. Certainly, the need for ongoing data collection is not indicated. Subject to further definition of the issues to be studied, I believe that the necessary data is available from within the industry.

There was a question concerning the role of the Federal Government. This is a complicated area with implications extending beyond those which would affect losses and premiums. The industry is regulated by the States and collective efforts among States have been successful in data collection and tort reform matters in the past. I appear before you today in a professional capacity. The issues controlling the respective roles of State and Federal Governments are matters beyond my professional capacity and therefore I make no opinion.

Thank you for the opportunity for addressing the committee.

Chairman LaFalce. Thank you, Mr. Cerone.

Our last witness will be Mr. Jay Angoff, counsel for the National Insurance Consumer Organization.

TESTIMONY OF JAY ANGOFF, COUNSEL, NATIONAL INSURANCE CONSUMER ORGANIZATION

Mr. Angoff. Thank you, Mr. Chairman.

Mr. Chairman, Mr. McDade, and members of the committee, I am Jay Angoff, counsel to the National Insurance Consumer Organization, and I appreciate the opportunity to testify here today.

Mr. Chairman, I would like to, particularly, thank you first for your interest in this issue over the years. I know that you, more than any other person in Congress, certainly since the last insurance crisis in 1975, have sought to find out exactly what is going on in the insurance industry. I know that you made a start 12 years ago, and I hope that after this insurance crisis that we can do something to maybe avert another insurance crisis 10 years down the road.

I think that there has been an enormous frustration among legislators, both on the Federal but, particularly, on the State level, over what has happened to insurance rates in the last 2 years.

And I think that regardless of what anyone's inclinations are that the one thing that all legislators have in common is that they want to find out exactly what is going on in the insurance industry, why rates are going up. They want to get the data. And over the last 2 years, they just have not been able to get the data.

There are five different types of data which legislators around the country have asked for and have not been able to get, and I would like to go through those one-by-one.

The first is a very fundamental question: How much do insurance companies pay out and how much do they take in for different types of insurance in each year in each State?

Today, believe it or not, insurance companies do not disclose how much they pay out and take in for different types of insurance. They do disclose certain data for a big broad category called other liability. But within other liability, there are such types of insurance as daycare center liability, municipal liability, nurse midwife liability, liquor liability, and products liability.

And around the country, what we have seen is rates for these different types of insurance skyrocketing, yet it has been impossible in most cases to actually find out from the insurance industry how much is paid out and how much is taken in for each of these types of insurance.

So, I think that the first thing that the Congress should do is to pass legislation requiring disclosure of the subcategories of general liability where rates have gone crazy during the last 2 years.

Also, under the first type of data, it is very important to get, not just the estimates of how much insurance companies pay out in the future, but how much has actually been paid out.

Typically, what insurance companies disclose is data for something called incurred losses, but incurred losses is not the amount actually paid out. It is the amount that is estimated to be paid out in the future. So it is important to get data on the amounts actually paid out and actually taken in for each type of insurance.

Chairman LaFalce. Let me just interrupt to clarify something. Ms. Walters was referring to paid losses, and you have been referring to incurred losses and losses paid out.

Are we talking about the same thing, or are we talking about two different things, or are we talking about three different things?

Mr. Angoff. We are talking about three different things.

Chairman LaFalce. Let me ask Ms. Walters what she was talking about first.

Ms. Walters. I was quite clear at the end of my testimony when I was talking about growth in paid losses, paid losses, not estimates for future liabilities.

Chairman LaFalce. You are talking about paid losses.

Ms. Walters. Paid loss growth was 100 percent.

Chairman LaFalce. It is not what the figure was, it is what you mean by paid loss.

Ms. WALTERS. Losses actually paid. Checks have been written to pay the losses.

Chairman LAFALCE. That does not include reserves that have been set aside?

Ms. WALTERS. No, sir; there are, basically, just two concepts of losses, incurred losses and paid losses. Paid losses are just what the common folk would think that you mean when you say paid losses, the losses have actually been paid. Incurred losses include paid losses plus an estimate of what you will eventually have to pay for that policy period.

Chairman LAFALCE. Paid is what you actually paid out?

Ms. WALTERS. Right.

Chairman LAFALCE. Is that exclusively paid out to the Plaintiff or is that totality of costs?

Ms. WALTERS. No; it is just paid losses. It does not include administrative costs as well.

Chairman LAFALCE. Fine. Thank you.

Mr. ANGOFF. Without dwelling on this subject, I think that there is just one point that should be pointed out.

Mr. MCDADE. Excuse me for just 1 second. I thought that there was a conversation about three definitions, and I heard you use two.

Ms. WALTERS. That is correct. I will let Mr. Angoff explain the third.

Mr. MCDADE. But you believe that there are only two definitions?

Ms. WALTERS. In a simple manner of speaking about things, yes. I would like Allan Kaufman to comment as well. I think that most of us as actuaries and accountants are familiar with insurance and financial reporting.

Chairman LAFALCE. There is no simple way of speaking about anything in the insurance industry.

Ms. WALTERS. Well, I think that it is very complicated, but we need not overcomplicate things. I think that there are paid losses and there are incurred losses and that is fundamental.

Mr. MCDADE. So your definition confines itself to two, and Jay would have a third category, and somebody else would want to comment on a third category?

Mr. ANGOFF. If I might, I would like to comment on the third category.

Chairman LAFALCE. I did not mean to interrupt or start the questioning period. I simply wanted to clarify.

Mr. MCDADE. Yes; and then after you raised it, John, there are two and three, and I heard two responses here and three here. So, I thought, perhaps, someone on the panel might want to contribute to whether there are two or three.

Chairman LAFALCE. Well, why do we not let Mr. Angoff finish.

Mr. MCDADE. Yes; fine. Thank you.

Mr. ANGOFF. As Mavis pointed out, I think that she used the word common folk. She said that common folk did not understand the word losses to mean what the insurance industry understands it to mean, and that is true. In the insurance industry, there is a broad category called incurred losses. Common folk, I think, would understand that to mean the amount paid out.

What it really means is that it includes three different types of losses; the amount actually paid out; the amount that insurance companies estimate that they will pay out on claims that have already been reported to the company, so that they can get some pretty good estimate on how much they are going to pay out; and then a big broad category which insurance companies call incurred but not reported which is the amount that they estimate they will eventually pay out on claims that have not been reported, but they predict will eventually be reported.

So, you can see that there is a lot of room for estimate in that number. So, those are the three types of categories of losses.

In any event, the second type of data which we do not have but which I think legislatures would like to get is data on the difference between the jury verdict and the amount that is actually paid out.

We see reports in the papers, often on the front page, of huge jury verdicts. I think one of the more well-known is the case of the Philadelphia woman who, supposedly, got a $1 million jury verdict last summer.

Now that is true. The jury did come down with a $1 million verdict and that was on the front page, but what was buried on page 23, someplace in a little paragraph 2 months later, was that the judge overturned the verdict. And as of now, the woman has gotten nothing, and probably will not get anything, and probably should not get anything.

But the public, and I am afraid that many legislators, see the page one story of the $1 million verdict and they do not see how much is actually paid out. It would be a very simple matter for insurance companies to report for each case that goes to verdict how much was the verdict and how much was the actual payout.

The third type of data is data on the effect of various legal doctrines on insurance company payouts. There has been a lot of debate, obviously, over whether to limit damages for paralysis, disfigurement, and other so-called noneconomic damages, whether they are punitive damages, and whether to modify the doctrine of joint and several liability.

And it would be a relatively easy thing to require insurance companies to disclose data on these three issues and others so that legislators could evaluate the effect of these doctrines on insurance company payouts and therefore on insurance rates.

For example, it would be very simple to require insurance companies, again, for each case to go to verdict, to answer the question how much did you pay for medical expenses and wage loss as economic damages, and then how much did you pay for damages other than that which are damages for so-called pain and suffering.

And you could easily find out, for example, in how many cases did you pay more than $250,000 for noneconomic damages. And then you could evaluate what the effect of limiting recoveries for noneconomic damages to $250,000 would be.

Similarly, for punitive damages, it would be a very simple thing to require insurance companies to disclose for each case, again, that goes to verdict, how much did you actually pay out for punitive damages, or similarly, to evaluate how the doctrine of joint and several liability could require insurance companies to disclose how often have you been involved in cases where there has been more than one defendant, and how many of those cases did you actually end up paying more than your equitable share, and how much more than your equitable share did you end up paying.

And again, based on these answers, you could get some idea of how much limiting recovery to injured people would reduce insurance rates by.

The fourth type of data is something that has been overlooked, I think, and that is data on the efficiency or inefficiency on the legal system. For example, it would be very simple to require insurance companies to disclose how much they paid indemnity, and, on the other hand, how much they paid their lawyers. If you concluded that too much was going to lawyers, then maybe you would want to put limits on lawyers' fees.

Or you could require insurance companies to disclose how long it takes the case to go from the time that the injury is reported to the insurance company to the time that the actual payout is made. If you concluded that the time took too long, then you might want to do things like put sanctions for delay or frivolous motions, objections, and defenses in order to try and get more money into the hands of the injured person more quickly. But in any event, you should get that type of data.

And then the fifth type of data also goes to a question that there has been a lot of debate on, and that is the accuracy. And this gets back to the question that you were asking, Mr. McDade, the accuracy of insurance company reserves. There are some who argue that the amount that insurance companies put aside for this big category called incurred but not reported, that is, their predictions of how much they are going to pay out on claims that they are going to predict that they will have, but they do not have yet, some claim that that amount is too great.

On the other hand, some insurance companies claim that they do not put enough aside. Well, it would be a simple matter to answer this question simply by asking for each claim that is paid out each year, ask the insurance company when did it set up a reserve for that claim. And when it did set up that reserve, how much was that reserve. And then by comparing the two numbers, you could get to the bottom of it.

Mr. Chairman, I would just like to conclude by reading from a report of your committee, questions from a report of your committee that you asked almost 10 years ago today. You asked a number of the major insurance companies the following question:

> Please supply information listing by year the number of product liability lawsuits initiated, the number of such suits won by the plaintiff, the number of out-of-court settlements and the amounts of the settlements, and the number of verdicts rendered for the defendant?

That is a pretty straightforward question and pretty basic information that we all would want to know. And here are the answers that you got back.

From Aetna:

> We do not maintain records which would enable us to provide complete answers to this question.

From AIG:

We do not maintain statistical records on the number of lawsuits initiated or their disposition.

From CNA:

The data requested is not maintained by CNA.

From Continental:

This information is not available.

From Crum & Forrester:

We cannot provide this information.

Mr. Chairman, you asked these questions almost 10 years ago. And I hope now, you will ask the same questions, and maybe this time we can finally get some answers. Thank you.

[Mr. Angoff's prepared statement, with attachments, follows:]

PREPARED STATEMENT OF JAY ANGOFF, COUNSEL, NATIONAL INSURANCE CONSUMER ORGANIZATION

Mr. Chairman and members of the Committee, I appreciate the opportunity to testify on the availability of insurance data to explain the causes of the liability insurance crisis.

Insurance companies have in their possession five types of data that legislators need in order to determine the causes of the recent insurance crisis and prevent its recurrence. With minimal exceptions set out below, insurance companies do not now disclose this information. I will discuss these five types of data in turn.

I. Data on the amount insurance companies take in and pay out for different categories of insurance.

It is important to get data both on actual payouts and for meaningful categories of insurance; today we have neither.

A. Categories

Today insurance companies disclose premium and loss data for "lines" of insurance as defined in the annual statement they file with each state insurance commission. Some "lines," such as private passenger auto, workers' compensation, and medical malpractice, are sufficiently discrete categories; there is no need to require insurers to disclose data for subcategories of those lines.

The line in the annual statement called "other liability," on the other hand, is a very broad category. It includes many subcategories of insurance, such as day care center liability, municipal liability, liquor liability, product liability and recreational liability, that are often referred to as "lines" but are not "lines" in the Annual Statement. Rather, they are either "sublines" (e.g., product liability), or "classes" (e.g., day care center liability). The Insurance Services Office (ISO), the industry organization which issues "advisory" general liability rates, also determines the sublines and classes of insurance, and collects and compiles data by subline and class. 1/ Nevertheless, neither ISO nor individual insurers currently disclose any premium or loss data by subline or class--including those for which insurers sharply raised rates during the last two years. The disclosure of such data would enable Congress to determine for itself whether recent insurance rate increases were justified.

B. Payouts

In addition to requiring disclosure of premium and loss data for the right categories of insurance, Congress must make sure to require the right kind of premium and loss data. As you know, Mr. Chairman, a "loss" in insurance industry jargon is quite different from a "loss" in common sense terms. Specifically, a loss for an insurance company in a given year is not what it pays out in that year, but rather the amount it estimates it will eventually pay out--over five or ten or even more years--on that year's policies. Thus, "losses" in the insurance industry for 1986 include both money that insurers actually paid out in 1986 and money that they estimate they will pay out in the future on policies in force in 1986. Their estimates of future payouts can also be divided into two categories: the amount they estimate they will pay on claims that have been reported, and the amount they estimate they will pay on claims they predict will occur and be reported in the future--their so-called "incurred but not reported" ("IBNR") losses. Because these are not actual payouts or even estimated payouts on known claims but rather predicted payouts on predicted claims, it is probably more accurate to call them "estimated contingent liabilities" rather than "losses." In any event, so that legislators can understand which "losses" are actual payouts and which are predictions, "loss" data should be clearly broken out into paid losses, losses that have been reported but not paid, and "losses" that have been "incurred" but not reported.

Unfortunately, the annual statement does not break out losses into those three categories in a readily understandable manner. The language attached as Exhibit 2, which has already been substantially enacted in about a dozen states, does. Congress should enact similar language. Legislators and the public could then draw their own informed conclusions about the legitimacy of insurers' incurred loss estimates. For example, if year in and year out paid losses remained relatively constant or declined, while "IBNR"-type "losses" skyrocketed, legislators might wish to question the reasonableness of insurers' incurred loss estimates.

II. Data on the extent to which verdicts accurately reflect the amount insurance companies actually pay out.

The insurance industry and the current administration have publicized cases in which juries rendered large and seemingly uncalled-for verdicts, such as the $1 million verdict for the Philadelphia woman alleging loss of psychic powers, and the $125 million Ford Pinto punitive damages verdict. Both these verdicts received prominent and extensive press coverage; when the judge overturned the "Philadelphia psychic" verdict, on the other hand, or when the judge remitted the $125 million Pinto punitive damage verdict to $3 million, there was little press coverage. Obviously, big verdicts are big news; small verdicts, or a judge overturning or remitting a verdict, or an out-of-court (and perhaps sealed) settlement are not big news. Yet the public and even some legislators may have the impression that the big verdicts that are reported are both typical and actually paid; to correct this impression Congress should require that insurers disclose, for each case in which a verdict had been rendered, both the amount of the verdict and the amount that is actually paid by the insurance company. In that way legislators could see the relationship of payout to verdict for verdicts of various sizes.

Ironically, both a recent study by the largely insurance-industry funded Rand Institute for Civil Justice, 2/ and a study by an American University professor for the plaintiff's bar, 3/ have found payouts for limited samples of cases to be less than half the verdict amount. The American University study found further that as verdicts rose, the ratio of payout to verdict sharply decreased. The Rand study looked at Chicago and San Fransisco verdicts; the AU study looked at verdicts of $1 million or more. Congress should require that insurers submit verdict/payout data so that it can determine whether the results of these studies are valid countrywide and for all sizes of verdicts.

III. Data on the effect of specific legal doctrines on insurance rates and injured people.

Will restricting various legal doctrines--such as non-economic damages, punitive damages, and joint and several liability--reduce insurance rates? This has been the fundamental question in the debate over limiting recovery for injured people. Those seeking such limits argue that rates have risen because liability has expanded; thus, if this theory is correct, limiting liability should reduce insurance rates. Others have argued that insurers raise rates or refuse to write insurance for reasons largely unrelated to liability doctrines, and therefore that limiting recoveries for injured people would be a useless exercise.

Fortunately, insurance companies have in their possession data that would enable legislators to determine the extent, if any, to which limiting specific legal doctrines would reduce insurance rates; unfortunately, insurers have so far almost uniformly refused to disclose such data. But Congress could require it, and insurance companies could easily produce it, for the following legal doctrines:

a) Non-economic damages. Insurers seek to limit damages for disfigurement, loss of bodily function and other pain and suffering--damages that cannot be quantified in terms of medical expenses or lost wages--to a specific amount, usually $250,000. To determine the extent to which limiting such so-called "non-economic" damages would reduce insurance rates, it is necessary to determine how frequently insurance companies actually pay out more than $250,000 in such damages. Because in most states juries must itemize verdicts, i.e., state how much they assess for lost wages, medical expenses, and other types of damages, insurers could easily disclose their payouts for "non-economic" damages in cases that are tried to verdict. 4/

Requiring insurers to disclose their payouts for non-economic damages in settled cases would be slightly more burdensome, but still quite feasible. Before settling any personal injury case, the defendant asks for and receives from the plaintiff his medical expenses and lost wages; it would therefore be quite simple for insurers to disclose, for cases they settle, how much they paid for medical expenses and lost wages and how much for "non-economic" damages. Insurers would need to do a computation for settled cases (subtracting lost wages and medical expenses from the settlement amount) that they would not need to do for cases tried to verdict (with respect to which they could simply look at a verdict sheet). Yet because so many more cases are settled than tried, Congress might view the benefit of requiring non-economic damage disclosure for settlements as well as verdicts as outweighing its cost--particularly if Congress requires such disclosure for settlements prospectively only, since insurers can quite easily develop reporting procedures for future cases.

The effect that limiting non-economic damages to $250,000 would have on injured people can also be answered by data which insurance companies have but up till now have not disclosed. For example, insurance companies could quite easily disclose the general category of injury (e.g., death, quadriplegia, brain damage, etc.) involved in cases where non-economic damages exceed $250,000. If such damages went for severe injuries legislators would obviously view them differently than if they went for relatively minor injuries.

b) Punitive damages. In several states insurers have sought to limit or eliminate punitive damages, on the grounds that they have been paying out higher punitive damage assessments, and paying them more frequently.

Congress could easily quantify the effect of punitive damages by requiring insurance companies to disclose, for each case tried to verdict, a) the amount of punitive damages assessed by the trier of fault, b) the amount of punitive damages actually paid, and c) the amount of punitive damages actually paid by the insurance company. (Because punitive damages are uninsurable as against public policy in many states, insurance companies do not pay such damages in many states.) Those amounts could then be compared to the total amount paid out by insurance companies each year in order to evaluate the impact of punitive damages. Because cases that are settled do not include any meaningful punitive damage component, disclosure of punitive damage payouts must be restricted to verdicts. The burden on insurers of punitive damage disclosure is therefore minimal. 5/

Two recent studies have, for limited samples, quantified the effect of punitive damages on insurer payouts, and have found it minimal. The Texas State Board of Insurance analyzed a sample of 3,367 claims paid in Texas during the last four years. Of $487 million paid out by insurance companies, it found that $100,000--or about 1/50 of 1%--was paid in punitive damages. 6/

Similarly, the Rand ICJ found that, while punitive damages in business litigation have been rising substantially, such damages "continue to be rarely assessed in personal injury cases." 7/ If the countrywide data are consistent with the findings of these two studies, then punitive damages, while deterring reckless behavior, would seem to have little or no effect on insurance company payouts and thus on insurance rates.

c) Joint and several liability. Under the doctrine of joint and several liability, an injured person is assured of recovering his damages if two or more defendants have combined to cause his injury. Since the injury would not have occurred but for the action of each defendant, each defendant is liable for the plaintiff's damages, but the jury allocates an "equitable" share to each defendant. Typically, each defendant pays its equitable share. For example, if three solvent defendants are equally responsible for the plaintiff's damages of $100, they will each pay the plaintiff $33.33. But if one of the defendants is insolvent, the others must make up its share.

Insurers claim that joint and several liability should be eliminated, and that each defendant causing an injury should be liable only for its "equitable" share, because a defendant with only a 1% equitable share could end up paying the plaintiff's entire damages.

Insurers currently have, but have not yet disclosed, the data that will allow legislators to determine how often "1%

defendants" end up paying the entire damages, and to evaluate the savings that would result if joint and several liability were eliminated. For example, insurers should disclose how often they are involved in cases with multiple defendants, how often they pay more than their equitable share in such cases, and how much more they pay. If the data showed that joint and several liability caused the insurance industry to pay out substantially more than it would if each defendant had only to pay its equitable share, then the case for eliminating joint and several liability would be stronger than if the doctrine had little effect on insurance industry payouts.

The studies that have been done to date all show the effect of joint and several liability to be nominal. The Texas State Board of Insurance, for example, found that for its sample insurance companies paid out 1.8% more because of joint and several liability than they would have if defendants had been liable for their equitable share only. 8/ Countrywide data are needed to determine whether that conclusion is valid countrywide.

Because insurers can only estimate their equitable share for cases that are settled, data on the effect of joint and several liability on settlements will be very soft. For this reason, and also to minimize the burden on insurers, we recommend that Congress require the disclosure of joint and several liability data only for verdicts (although Texas did require data for both verdicts and settlements).

A bill introduced in California and several other states, which would require the disclosure of data on the effects of legal doctrines on insurer payouts, as well as the relationship of verdicts to payouts and the accuracy of insurer reserves (see V, infra,), is attached as Exhibit 3.

IV. Data on the efficiency of the legal system.

Somewhat overlooked in the debate over limiting recoveries is the question whether reducing the overall costs of the system will reduce rates. Many believe that the legal system is inefficient: that too much of each dollar flowing through the system goes to lawyers and for other "loss adjustment expenses," and that cases take too long. In order to quantify these inefficiencies, Congress should require insurers to disclose, by type of case and by payout level, how much they pay their lawyers and how much they pay in indemnity (out of which, of course, the plaintiff's lawyer must be paid). If legislators concluded that, for certain types of cases, lawyers were getting too much of the premium dollar and injured people not enough, 9/ legislators might want to limit lawyers fees--particularly defense lawyers' fees, which unlike those paid by the plaintiff are passed through to the policyholder in the form of higher rates.

Insurance companies should also disclose, and can easily disclose, the average length of time it takes to resolve cases. The Texas Insurance Commission, for example, found that on average it took injured people more than 2 1/2 years to receive payment from the insurer after they reported their claim to the insurer. 10/

If insurer data showed this phenomenon to exist nationwide, Congress might want to enact legislation speeding up cases--such as severe and mandatory sanctions for delaying tactics, including frivolous motions, objections and defenses. 11/

V. Data on the accuracy of insurance company reserves.

Insurance companies set up "loss reserves" for claims they have not yet paid but which they predict they will pay in the future. 12/ The rates they charge are based on these reserves, and they have historically been able to take an immediate tax deduction for the entire amount reserved--even if they have not actually paid out most of that amount. 13/ Insurers therefore have an incentive to overstate their reserves.

On the other hand, insurance companies argue that they actually reserve too little--that they will ultimately pay out more on 1984 policies, for example, than they reserved in 1984 for 1984 policies.

Congress can determine for itself the accuracy of insurance company reserves by requiring insurance companies, for each claim they pay each year, to answer three easy questions: (1) What was the amount you paid?; (2) When did you set up a reserve for that claim?; and (3) What was the amount reserved?

After the insurance crisis of 1975, Kansas enacted a statute essentially asking these questions. 14/ Kansas found that claims paid in 1977 were 42% of the original reserves for these claims. Even without taking investment income into account, Kansas insurers had reserved more than twice what they should have. By enacting a statute similar to the Kansas statute Congress could determine the accuracy of reserves set by insurance companies nationwide.

Presently insurers do not evaluate the accuracy of their reserve estimates by looking at how much they actually paid on a claim and then asking how much they had originally reserved on that claim. Rather, they look at how much they reserved in a given year on policies in effect in that year, and then see how accurate that reserve estimate turns out to be as the claims are actually paid over time. The obvious disadvantage of this approach is that the accuracy of the reserves set up in any given year cannot be evaluated until many years after the reserves are set up. If Congress were to look at actual paid claims and compare them with the reserves for those claims, its evaluation of the accuracy of insurer reserves would be much more timely.

The Appropriate Role for the Federal Government in Collecting Data

The states have asked the federal government for help in collecting data. They believe the insurance data they currently have are inadequate, and that they could better regulate the industry and better assess the relationship between insurance rates and the legal system if they had better data. 15/

During the last two years, both state and federal legislators have become increasingly frustrated with the failure of insurance companies to reveal basic information such as the amount they pay out for specific kinds of insurance, or the amount they pay out for punitive damages or non-economic damages. As a result, several legislators, and a few Insurance Departments, have taken the first tentative steps toward requiring insurance companies to disclose meaningful information.

If Congress required insurers to report the five types of data I have discussed above to Congress, and Congress made the data available to the states, state insurance commissions could do a better job of regulating, and state legislators could more knowledgeably act to prevent future insurance crises.

FOOTNOTES

1/ A list of some ISO classes is attached as Exhibit 1.

2/ Rand Institute for Civil Justice, "Punitive Damages: Empirical Findings," No. R-3311-ICJ (1987).

3/ I. Broder, "Analysis of Million Dollar Verdicts" (Oct. 1986).

4/ Missouri recently enacted legislation requiring insurers to disclose their payouts for non-economic damages that exceed $300,000 in cases tried to verdict.

5/ Missouri recently enacted legislation requiring insurers to disclose their payouts for punitive damages that exceed $300,000.

6/ Texas State Board of Insurance, Texas Liability Insurance Closed Claim Study, at 89 (Feb. 1987) (hereinafter "Texas Study").

7/ "Punitive Damages: Empirical Findings," supra note 4; see also "Rand Says Damages Rare in Personal Injury Cases," Vol. 1, No. 34 Liability & Insurance Bulletin, Mar. 30, 1987.

8/ Texas Study at 8, 26, 73. Because of the manner in which the data were reported, the Taxas Board notes that even this 1.8% overstates the effect of joint and several liability.

9/ For example, the Texas Board found that for relatively small medical malpractice cases, insurers paid more to their own lawyers than they paid to the plaintiff and his lawyer combined. Texas study at 124.

10/ Texas study at 43. This should not be surprising, since every day the defendant avoids paying money to the plaintiff is another day that that money can be earning interest for the defendant. It is also another day during which defense lawyers, who are paid by the hour, can keep their meters running.

11/ If such sanctions were enacted, sanctions for frivolous complaints would also make sense.

12/ See discussion in Section I, supra.

13/ Under the tax reform act of 1986, insurers will in the future be required to discount their reserves to partially take account of inflation, although they can still deduct the entire amount, as discounted, in the tax year.

14/ Kan. Stat. Ann. Section 40-1130(a) (Supp. 1979).

Exhibit 1

APPENDIX

General Liability Insurance
Owners, Landlords and Tenants

Class Definitions

Code	Description
82115	Day Nurseries
	Liquor Liability *
70412	Clubs
59211	Package Stores and other retail establishments
50911	Manufacturers, Wholesalers and Distributors
58161	Restaurants, Taverns, Hotels, Motels
58168	Temporary Licensees
58169	Owners or Lessors of premises used by others
	For states where no liability is imposed by statute or under Common Law:
70414	Host Liability
11111	Liquor Liability, not otherwise classified
	Municipal Classes
91250 thru 91263	Governmental Subdivisions
82113, 82116, 93221	Public Schools
92151, 92153, 93151	Streets and Roads
93050	Government Composite Rated Risks
93111	Government Employees
93155	Play Streets
93164	Permits - Municipal
	Related Non-Municipal Classes
41711	Bus Stations
44631 44632 44633 44639	Wharf or Waterfront Property
45836	Airports - Commercial
47841	Toll Bridges
47850	Drawbridges
92154	Highways or Roads - Dept. of Public Works

* There are special codes for Michigan and West Virginia, not listed here.

Related Non-Municipal Classes, continued

91188 91231 92181 92182 92184 92185 92186 92187 93181 93182 93183 93184 93185	Housing Projects
93131	Fire Houses

Recreational Classes

79492	Archery Ranges
79422	Athletic Games
79495	Athletic or Sports Contests in Buildings
79429	Athletic Teams
79482	Automobile Racing
79495	Automobile Shows
79411, 79436	Baseball Parks
79493	Bathhouses or Bathing Pavilions
80927	Baths
79426	Bazaars - op. by insured
79428	Bicycles rented to others
79300	Billiard or Pool Halls
79424	Bingo Games . . . Community Operated
44696	Boats - canoes or rowboats
44693	Boats - motor or sail - for hire
44595	Boat yards or marinas - public
79300	Bowling Alleys
86416	Boy or Girl Scout Councils
86413	Boy or Girl Scout Troops
70322	Camps - boy or girl
70321	Camps - boy or girl, non-profit
80998	Camps - first aid to campers
79221	Carnival or Circus Cos.
79421	Carnivals
79464	Circuses
86415	Clubs - Civic, fraternal, luncheon, service, social
79472	Clubs - country, golf, polo, tennis
70411	Clubs - lodges, fraternal orders, sororities
79496	Clubs - riding - private (not academies)
79411	Clubs - riding - private academies
86990	Clubs - Swimming
86110	Conventions
79112	Dance Halls
79483	Dog Racing

Recreational Classes, continued

79467	Dog Shows - outside
70323	Dude Ranches
80996	Exercise or Health Institutes
79495	Exhibitions - in buildings
79413, 79462, 79418	Exhibitions - outside
86414	Fair Grounds
79465	Fairs
79463, 79461	Fireworks exhibitions
79497	Golf Courses - miniature
79420	Golf Courses - municipal or public, not golf or Country Clubs
79492	Golf Driving Ranges
93120	Halls
79483	Horse Racing
79466	Horse Shows
79302	Model Airplane Contests
08444	Motorcycle Racing
82310	Museums
79303	Parades
86414	Parks or Playgrounds
79431	Penny Arcades
79305	Picnic Grounds - commercially operated
79483	Race Tracks
86411	Recreation centers
79496	Riding Academies
79255, 79308	Rifle Ranges
79468	Rodeos, including parades
79431	Shooting Galleries
79451	Skating Rinks - ice
79452	Skating Rinks - roller
41191	Ski lifts or tows - including ski runs - commercially operated
79481	Soap Box Derbies
79111	Social Gatherings and Meetings
79401	Sports Programs - youth
79413, 79414	Stadiums
79416, 79417	Swimming Pools
47894	Teams
79492	Tennis, Handball or Shuffleboard Courts
78321	Theatres
78330, 78331	Theatres - drive-in
78329	Theatres - halls or auditoriums
78320	Theatres - motion picture
86411	YMCA or YWCA
86414	Youth recreation programs

Exhibit 2

Hawe BILL NO. 430

INTRODUCED BY Blaylock Meyer

Vincent Bishop

A BILL FOR AN ACT ENTITLED: "AN ACT PROVIDING FOR THE DISCLOSURE OF LOSS AND EXPENSE EXPERIENCE BY PROPERTY AND CASUALTY INSURERS FOR PURPOSES OF DETERMINING THE APPROPRIATENESS OF RATES CHARGED BY SUCH INSURERS; PROVIDING A PENALTY; AND REPEALING SECTION 33-16-202, MCA."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Financial disclosure reports required -- rulemaking. The commissioner shall promulgate rules requiring each authorized insurer writing property or casualty insurance in Montana to record and report its loss and expense experience and other data the commissioner finds necessary to determine whether rates are fair and appropriate. The commissioner may designate one or more rating organizations or advisory organizations to gather and compile such experience and data. The commissioner shall require each authorized insurer writing property or casualty insurance in this state to submit an annual report, on a form furnished by the commissioner, showing its direct writings in this state and in the United States.

Section 2. Content of direct writings report. (1) The direct writings report required by [section 1] must include

but is not limited to the following specific types o insurance written by the insurer:

(a) political subdivision liability insurance reporte separately in the following categories:

(i) municipalities;

(ii) school districts; and

(iii) authorities;

(b) public official liability insurance;

(c) dram shop or tavern owners liability insurance;

(d) day-care center liability insurance;

(e) errors and omissions liability insurance;

(f) officers and directors liability insuran reported separately as follows:

(i) nonprofit entities; and

(ii) for-profit entities;

(g) products liability insurance;

(h) medical malpractice insurance;

(i) attorney malpractice insurance;

(j) architect and engineer malpractice insurance; ar

(k) motor vehicle insurance, reported separately f commercial and private passenger vehicles as follows:

(i) motor vehicle liability insurance first-par benefits;

(ii) motor vehicle bodily injury liability insurar

(iii) motor vehicle property liability insurance;

INTRODUCED BILL
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(iv) uninsured motorist insurance; and

(v) underinsured motorist insurance.

(2) The direct writings report must include the following data, specific both to this state and to the United States, by the type of insurance for the previous year ending December 31:

(a) direct premiums written;

(b) direct premiums earned;

(c) net investment income, including net realized capital gains and losses, using appropriate estimates where necessary;

(d) data for each of the following categories used to develop the sum of incurred claims:

(i) dollar amount of claims closed with payment; plus

(ii) reserves for reported claims at the end of the current year; minus

(iii) reserves for reported claims at the end of the previous year; plus

(iv) reserves for incurred but not reported claims at the end of the current year; minus

(v) reserves for incurred but not reported claims at the end of the previous year; plus

(vi) loss adjustment expenses for claims closed; plus

(vii) reserves for loss adjustment expenses at the end of the current year; minus

(viii) reserves for loss adjustment expenses at the end of the previous year;

(e) actual incurred expenses allocated separately to loss adjustment, commissions, other acquisition costs, advertising, general office expenses, taxes, licenses, fees, and all other expenses;

(f) net underwriting gain or loss;

(g) net operation gain or loss, including net investment income;

(h) the number and dollar amount of claims closed with payment by year incurred and the amount reserved for them;

(i) the number of claims closed without payment by year and the dollar amount reserved for those claims; and

(j) any other information requested by the commissioner.

(3) For the first year in which the insurer is required to file a direct writings report, the data required by subsections (2)(a) through (2)(g) must include the previous calendar year and each of the preceding 4 calendar years.

Section 3. Duty of commissioner. It is the duty of the commissioner to annually compile and review all reports submitted by insurers under [sections 1 and 2] to determine the appropriateness of premium rates for property and casualty insurance in this state. The commissioner's

Exhibit 3

CALIFORNIA LEGISLATURE—1987–88 REGULAR SESSION

ASSEMBLY BILL No. 2354

Introduced by Assembly Member Killea

March 6, 1987

POSITION defer
PRIORITY
SUBJECT Ins
COMM. Ins

An act to add Article 3.5 (commencing with Section 12960) to Chapter 2 of Division 3 of the Insurance Code, relating to insurance.

LEGISLATIVE COUNSEL'S DIGEST

AB 2354, as introduced, Killea. Insurance: information.

Existing law provides for the submission of various information to the Insurance Commissioner dealing with the business of insurance in this state.

This bill would, in addition, enact the Insurance Information Act of 1987 to require each insurer issuing or delivering insurance policies in this state to report annually to the commissioner various specified information dealing with the relationship between insurance premiums and the legal system. The bill would require the commissioner to prepare and issue, as prescribed, an annual report summarizing the information received under this act, which would be submitted to the Governor and the Members of the Legislature and made available to the public.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

SECTION 1. Article 3.5 (commencing with Section 12960) is added to Chapter 2 of Division 3 of the Insurance Code, to read:

Article 3.5. Insurance Information

12960. This article shall be known and may be cited as the "Insurance Information Act of 1987."

12961. The Legislature finds and declares that no independent data-gathering body exists within the state government or elsewhere to analyze the relationship between insurance premiums and the legal system, in order to assist the state in formulating policy relating to the insurance industry. The purpose of this article is to assure the availability of accurate data on the relationship between insurance premiums and the legal system by requiring insurance companies which issue or deliver insurance policies in this state to report the data to the commissioner.

12962. Each insurer issuing or delivering insurance policies in this state shall report annually to the commissioner the following information both for this state and the United States as a whole, after January 1, but not later than March 31, of each year, which shall contain the information for the calendar year preceding the calendar year in which the report is filed:

(a) For claims paid by the insurer during the calendar year, in which a verdict had at any time been rendered, as follows:

(1) The dollar amount paid by the insurer.

(2) The dollar amount of the original verdict.

(b) For claims paid by the insurer during the calendar year, in which a verdict had at any time been rendered, as follows:

(1) The dollar amount of the original verdict, broken out as follows:

(A) The total amount of past economic damages assessed by the trier of fact.

(B) The total amount of future economic damages assessed by the trier of fact.

(C) The total amount of compensatory noneconomic damages assessed by the trier of fact.

(D) The total amount of punitive damages assessed by the trier of fact.

(2) The dollar amount paid by all parties.

(3) The dollar amount paid by the insurer.

(4) The number of claims paid by the insurer.

(c) For claims paid by the insurer during the calendar year, in which a verdict had never been rendered, as follows:

(1) The total amount paid by insurer, broken out as follows:

(A) The amount of the plaintiff's past economic damages, as submitted by the plaintiff.

(B) The amount of the plaintiff's future economic damages, as estimated by the insurer.

(C) The amount paid by the insurer for other damages.

(2) The number of claims paid by the insurer.

(d) The number of claims in which the insurer paid more than two hundred fifty thousand dollars ($250,000) in noneconomic damages and more than five hundred thousand dollars ($500,000) in noneconomic damages.

(e) For claims paid by the insurer during the calendar year, the number of claims in which the punitive damages were assessed by the trier of fact, punitive damages were paid by any party, and punitive damages were paid by the insurer.

(f) For claims paid by the insurer during the calendar year, as follows:

(1) The dollar amount of punitive damages assessed by the trier of fact.

(2) The dollar amount of punitive damages paid by all parties.

(3) The dollar amount of punitive damages paid by the insurer.

(g) The number and dollar amount of claims paid by the insurer during the calendar year in which parties other than the insured had at any time been found liable by the trier of fact, or had been estimated by the insurer to have some liability.

(h) For those claims in which parties, other than the insurer of the insured had at any time been found liable by the trier of fact, or had been estimated by the insurer to have some liability, the amount by which the amount paid by the insurer exceeded the amount proportional to the insured's percentage of responsibility.

(i) For the amount paid in claims by the insurer during the calendar year, as follows:

(1) Total amounts reserved with respect to those claims.

(2) The year in which the reserves were set.

(3) The amounts set in each year.

12963. The commissioner shall prepare and issue, not later than September 30 of each year, an annual report, summarizing the information received under this article. Copies of this report shall be submitted to the Governor and each Member of the Legislature, and shall be made available to the public upon request.

Chairman LaFalce. Well, thank you very much, Mr. Angoff, and especially for reading from the questionnaire that we did send out 10 years ago and the responses. That is why, when individuals ask me, "Why are you looking at the availability of data, why are you looking at the causes, why do you not start having a hearing on the solutions?," that I say, "Well, let us get some answers to some of my questions first."

And when I have not gotten answers to my questions over a period of a decade, and we have the same arguments being made, that gives me cause for concern. I have mellowed over the years, and maybe I am accustomed to not getting answers to these questions.

Ms. Walters, when I heard you use the words "paid losses," it seemed to me that in all of the years that I have been talking with you, that maybe you have used that phrase before, but I do not ever recall you using that phrase before, "paid losses." I recall you using the word "losses," you know, "incurred losses," IBNR, but I have never heard you talk about "paid losses."

And then when I look over reporting information, I see all sorts of information that is reported: Developed incurred losses, exposures, number of claims, pure premium, loss ratio, et cetera.

Whenever the insurance industry, or any group, comes before me, they talk about "loss ratio," they talk about "loss adjustment expenses," but I have never heard them talk about "paid losses."

Now to what extent has the insurance industry presented data to the public and to the public officials regarding "paid losses." Now you have not done it today. You just said "paid losses" increase by so much percent in comparison with an increase in GNP or an increase with other things. But percentages do not mean very much unless we know a great deal more.

So, to what extent has the insurance industry given the public and public officials information about "paid losses?"

Ms. **Walters**. We have shared with officials all over the country, exactly the kind of information that we have shared with you today.

Chairman **LaFalce**. Well, that is not much. That is percentages.

Ms. **Walters**. Let me elaborate. I made reference to the booklet. This presents information that is available on a country-wide basis. The identical information, State-by-State, has been given to every State insurance department, and to every State legislative group that has been asking for information by individual class of business.

This information, of course, is earned premium, incurred losses, number of claims, and loss ratios. The reason that most insurance people will speak of incurred losses——

Chairman **LaFalce**. Incurred but not paid?

Ms. **Walters**. Right.

Chairman **LaFalce**. My question is about "paid losses," and you waved a book at me and said here is the book.

Where is "paid losses" in the book?

Ms. **Walters**. The paid losses are not included in the incurred losses, of course, but they are not separately shown because——

Chairman **LaFalce**. Separately shown, where are they separately shown?

Ms. **Walters**. They are not, Mr. Chairman.

Chairman **LaFalce**. We do not have information about "paid losses."

Ms. **Walters**. Well, we have information about country-wide paid losses by line of business.

Chairman **LaFalce**. Where in the book?

Ms. **Walters**. The charts at the back of this book, I guess, show growth. These would be growth in incurred losses. So this book does not have paid losses. This financial analysis was given to every State legislative authority who has looked at this question, and has information on total financial analysis of the insurance industry, growth in——

Chairman **LaFalce**. Paid losses?

Ms. **Walters**. Yes, sir; the figures that I quoted today are shown on page 10, paid losses.

Chairman **LaFalce**. That is the percentage increase.

Ms. **Walters**. That is right.

Chairman **LaFalce**. That is almost meaningless, the percentage increase. I did not say that it is meaningless, I said almost meaningless. I want the data on the "paid losses."

Where is it, dollars and cents over the years?

Ms. **Walters**. That kind of information could be provided to you, Mr. Chairman.

Chairman **LaFalce**. Oh, it could be, but you said that it had been provided to virtually every public official in every single State; where is it?

Ms. **Walters**. No, sir; I did not say that. I said information on paid losses has been provided.

Chairman **LaFalce**. Oh, some information on paid losses, those percentages. I want to know the "paid losses."

Do we have that information or do we not have that information. Is it available or is it not available?

Ms. **WALTERS**. Certainly, it will be available if you would desire to see it. I can explain to you why we have not provided that information to anyone?

Chairman **LAFALCE**. You have not provided that information to anyone.

Ms. **WALTERS**. Let me back up. It is not true that we have not provided that information to anyone. We were specifically required by-——

Chairman **LAFALCE**. I asked for this information 10 years ago, Ms. Walters.

Ms. **WALTERS**. We will both go back and check our records, Mr. LaFalce. We have provided you with everything that you have asked. And I think that you have to acknowledge over the past 10 years that we have provided you with everything that you have asked.

Last year, Mr. Rodino specifically requested a break-out of paid losses. We presented him exhibits breaking out paid losses. I will see to it that you get those identical exhibits.

I would like to explain why we do not routinely distribute those exhibits. It is very simply because that information is incomplete, terribly misleading, and would lead people to the wrong conclusions. The insurance premium must cover not just the losses that you paid the first year, but the losses that you have to pay each year that are covered by that premium.

Chairman **LAFALCE**. Counsel, who has dealt with you, advises me that, in this mountain of information that you have given us, that you have not given us "paid losses." Counsel advises me that, in the mountain of information that you have given us thus far, you have not given us, over the past 2 years, you have not given us information on "paid losses."

Ms. **WALTERS**. Frankly, Mr. Chairman, I was unaware that you had specifically asked for information on paid losses.

Chairman **LAFALCE**. You have just said that you have given it to me.

Ms. **WALTERS**. You were talking about over the past 10 years. I am talking about this last go-around 10 years ago in the mountains of information.

Chairman **LAFALCE**. In the past 2 years.

Ms. **WALTERS**. That information can be sent to you this afternoon.

Chairman **LAFALCE**. Ten years ago, the information was not available. That is what all of the insurance companies said, and Mr. Angoff quoted it. Now within the past 2 years, have they collected that information?

Ms. **WALTERS**. I am telling you that those exhibits have already been prepared, because Mr. Rodino asked for exactly the same thing, and we can send them to you this afternoon.

Chairman **LAFALCE**. All right, fine. We will await them then. All right, fine.

Mr. Delfico, do you think that "paid losses" are somewhat relevant in determining adequacy of rates?

Mr. DELFICO. In trying to relate the tort reform changes to premiums——

Chairman LAFALCE. A little louder, please.

Mr. DELFICO. I think in trying to relate the tort reform changes to premiums, yes; paid losses are adequate to rates, are important to determining rates. I think we, in our analysis, try to take a look at those factors of losses that should be considered in relating tort reform to premiums. We found that, also, the incurred but not reported are also very important. The components of that total package are what we tried to do to relate to tort reform.

Chairman LAFALCE. Absolutely, all of them are important.

Mr. DELFICO. Yes; I do think the components to report and the totals and——

Chairman LAFALCE. What information do you think is relevant for us in making appropriate public policy judgments with respect to the so-called crisis, and what information is available, and what information is not available, Mr. Delfico? And please feel free to have Ms. Ekstrand or Ms. Kladiva assist us.

Mr. DELFICO. Well, to start off with, we have done a number of closed claims studies with the insurance industry, but have not had access to the files. So, I cannot answer, specifically, what's there. We could not verify that.

Chairman LAFALCE. My question is not what is there. My question is what type of data is necessary for us to make intelligent public policy judgments with respect to the liability insurance crisis, in particular, in some of the proposed recommendations for changes.

Mr. DELFICO. Well, loss ratio——

Chairman LAFALCE. And to determine whether or not the rates being charged are being caused by a civil justice system going array or by some other practices of the insurance industry itself such as underwriting practices.

Mr. DELFICO. OK. As I mentioned in the testimony, there are a number of specific items, but Ms. Ekstrand can answer that question, specifically.

Ms. EKSTRAND. I think if the bottom line question is really whether the tort reforms are going to reduce insurance premium amounts that——

Chairman LAFALCE. Well, that is assuming you jump to tort reform in the first instance.

Ms. EKSTRAND. That is right, correct.

Chairman LAFALCE. But before you jump to tort reform, you have to ask whether the present system of tort law is responsible for the precipitous increases or are there some other reasons responsible. So, do we have the data to answer that threshold question first. This is one of the problems I have with the so-called closed claims study that is presently being conducted by ISO because it does not answer the first question. It immediately goes to the second question.

Ms. EKSTRAND. The information that Mr. Angoff listed in his testimony would provide some of the information needed to be able to answer the first question as to whether the civil justice system was the cause of the problem.

Chairman LAFALCE. So you have just said the information requested by Mr. Angoff would provide some of the information. I infer from that, therefore, that the information he says is necessary is not available, and that there might be additional information because you said that some would be required.

Now as to my two inferences, am I correct or incorrect? Do you understand my two inferences?

Ms. EKSTRAND. Yes, sir.

Chairman LAFALCE. All right.

Ms. EKSTRAND. We have not seen or been able to have access to the kinds of information that Mr. Angoff is suggesting.

Chairman LAFALCE. It is not public knowledge?

Ms. EKSTRAND. We have not been able to get that type of information in the studies we have done on insurance.

Chairman LAFALCE. And you think it is necessary in order to make intelligent judgments on our part?

Ms. EKSTRAND. They seem to be the types of information that would be necessary.

Mr. DELFICO. At this stage in our analysis, Mr. Chairman, I think the answer there is yes. I think it is necessary to get that information. As I mentioned earlier, we are in the early parts of our analysis and our indications are that the data may be there but we do not have it.

When you ask who has the information or can we get it, I think they are two different questions. I think accessibility to that information is limited from our standpoint.

Chairman LAFALCE. Sure. There is so much data available that you could just get lost in the world of data.

Mr. DELFICO. That is right.

Chairman LAFALCE. So you cannot do anything with it. I understand that. Then you have to try to break it down, too.

Mr. DELFICO. Ms. Kladiva has another input on her malpractice work.

Chairman LAFALCE. Yes.

Ms. KLADIVA. I would like to make the comment, specifically, with reference to availability of data on paid losses. In the work that we did in medical malpractice, we did State study work in six States. We visited 27 different insurers. They provided a whole host of statistical data to us and included in that was paid losses for 1980 through 1984. So the information was made available for us.

Chairman LAFALCE. For medical malpractice.

Ms. KLADIVA. For medical malpractice; yes.

Chairman LAFALCE. Is that information readily available. I mean in some written form to scrutinize, or do you have to ask for it?

Ms. KLADIVA. It has been published in a report that we issued December 31, 1986.

Chairman LAFALCE. Other than in our report, I mean. If GAO had not been going to make that report.

Ms. KLADIVA. I think the data is reported in A.M. Best.

Chairman LAFALCE. Paid losses is in A.M. Best?

Ms. KLADIVA. Through the annual reports that are required by insurers to file with State insurance commissioners. It breaks the data out in losses. The loss development schedules are provided in the annual reports in Schedule P that talk about incurred losses, and then they break it out by the amount that are paid, the amount that are reserves including IBNR's in the amount of IBNR.

Chairman LaFalce. OK. For whatever lines they report out, is that correct?

Ms. Kladiva. That is correct. Which medical malpractice has been——

Mr. McDade. What is IBNR?

Ms. Kladiva. Incurred but not reported.

Chairman LaFalce. Mr. Angoff, what would you say to that?

Mr. Angoff. Medical malpractice is a separate line in the annual statement. Other liability—the other things, daycare center, products, municipal, liquor, recreation classes, those are not separate lines, so you can, today, get more data for medical malpractice than you can for the other types of general liability.

You cannot get data easily on the three different types of so-called losses, that is, paid, reserved for cases that have been reported but not paid, and reserved for cases that haven't been reported but they think they are going to occur.

By flipping through the annual statement and doing some calculations among numbers on different pages, for medical malpractice you can get that, but no data on either medical malpractice or the other general liability lines is readily available on a form that either the public or legislators would understand.

Chairman LaFalce. Is it not true that the problem is not, necessarily, with the lines of business which are enumerated with some specificity, for example, fire, or earthquake, or medical malpractice, or ocean marine, or inland marine, or group accident, or health, or workers' compensation, but that the primary problem is with what is generally referred to as either "other liability" or "general liability," because that is such a catch-all? And is not the liability insurance crisis that we have had, in large part, due to the problems that have come about under that line called "general liability" or "other liability" insurance?

Mr. Angoff. Yes; and the tragedy is that legislators have felt pressured and now in some ways, really, it is too late for this crisis, but in the State levels, legislators have felt pressured to do something because what they could see was insurance rates were going crazy. And, therefore, I think unfortunately, a number of them enacted legislation based on no data which now we are seeing is not doing any good.

Chairman LaFalce. Right. Let me just ask a few questions of Ms. Walters.

Some very pedestrian problems, or I should not say pedestrian, but local problems in my district. Daycare centers, would they be included under "other liability?"

Ms. Walters. Yes; as I said in my statement, there are two separate ways of looking at it. There is the annual statement line of business which is very broad as you say, it's other liability, and then there is information available under statistical plans which is much more detailed, which separates out from other liability, in fact 1,100 distinct separate classes, one of which is daycare centers.

Chairman LaFalce. All right. And also under "other liability," we have some other problems. Some of my municipalities have had difficulties.

Ms. **Walters**. Right, governmental subdivision——

Chairman **LaFalce**. Would they be under "other liability?"

Ms. **Walters**. That is right, they would be under that line of State line of business.

Chairman **LaFalce**. I have had some church groups that used to run lawn fairs. They have not been able to run lawn fairs because they could not get insurance. Are they under——

Ms. **Walters**. They are under.

Chairman **LaFalce**. I have had some clergymen who have complained that their insurance went up about 500-600 percent. Where would they be, under "other liability?"

Ms. **Walters**. Yes; there are 1,100 classes in there.

Chairman **LaFalce**. All right. I had some individuals who used to conduct a skating rink, and they had to close down. Would they be under "other liabilities?"

Ms. **Walters**. Yes.

Chairman **LaFalce**. Et cetera.

So, there are about 1,100 different things under——

Ms. **Walters**. We have defined 1,100 separate classes. There may even be others that——

Chairman **LaFalce**. So there are at least 1,100 others.

Ms. **Walters**. That is right.

Chairman **LaFalce**. Now there are two different kinds of reporting, one of which breaks it out and one of which does not break it out?

Ms. **Walters**. Well, there are two broad categories. There is a financial statement which is the annual statement, and there are 32 annual statement lines of business. As I said in my formal testimony, what is the purpose of the annual statement, why does that exist for solvency, profitability, for those kinds of measures.

To look at the proper relationship between premiums and losses, one goes to statistical plan information because that is the precise reason why that kind of information was developed. The ISO Commercial Statistical Plan probably has about 1,300 pages in it. It stands this high, and it is the instructions to insurers that tells them how to report, what to report, in what format.

Chairman **LaFalce**. Right. These various lines that I have been talking about, fire, allied lines, farm owners, multiple peril, et cetera.

Ms. **Walters**. Right.

Chairman **LaFalce**. There are 30 some of these altogether?

Ms. **Walters**. Thirty-two are currently within the annual statement.

Chairman **LaFalce**. All right, 32, including "other liability."

For the 31, besides "other liability," do you have "paid losses" reported for each of those 31?

Ms. **Walters**. In fact, in the annual statement, the paid losses are shown on page 14 in the annual——

Chairman **LaFalce**. For what, the 31 others?

Ms. **Walters**. Every line of business in the annual statement—on page 14 of the annual statement it breaks out the losses. It shows paid losses.

Chairman **LaFalce**. 1,100 within other?

Ms. WALTERS. No, sir; the annual statement, by the 32 annual statement lines of business.

Chairman LAFALCE. So, there is an aggregate breakout for "other liability" insofar as paid losses are concerned.

Ms. WALTERS. That is correct.

Chairman LAFALCE. OK.

Ms. WALTERS. That is the source we used, in fact, to come up with these numbers they quoted earlier.

Chairman LAFALCE. All right. Now since there are at least 1,100 classes, my question is do we break down the "paid losses" for each of those 1,100, because if you have a problem with 2 or 3, or 200 or 300, and you have absolutely no problem with 200 or 300 others, might not the problems in one affect the problems in the other, and also inappropriately?

Ms. WALTERS. I am not sure I understand your question.

Chairman LAFALCE. Well, do we have a separate breakdown of the "paid losses" for each of those 1,100 classes?

Ms. WALTERS. In the statistical plan, the form in which insurers report the data to us, we can identify, separately, the paid portion.

Chairman LAFALCE. Do you?

Ms. WALTERS. No.

Chairman LAFALCE. All right.

Ms. WALTERS. We do not because it is meaningless for practically any kind of analysis you want to do which compares——

Chairman LAFALCE. Well, Mr. Delfico does not think it is meaningless. Mr. Angoff does not think it is meaningless. Do you think it is meaningless, Mr. Cerone?

Ms. WALTERS. You have to look at the purpose for which you are making an analysis. If you are looking at the propriety of premiums, you cannot just compare those premiums to the paid losses, because those premiums have to be sufficient.

You charge a premium to cover an insurance policy. That amount has to be sufficient not just to cover the losses——

Chairman LAFALCE. Well, it would be insufficient if you only put down "paid losses," but it would be insufficient if you did not put down "paid losses?"

Ms. WALTERS. No.

Chairman LAFALCE. I have no problem with getting information other than "paid losses." I have a problem with not breaking out "paid losses" for these different lines.

The gentleman with Mr. Cerone wanted to contribute something to this.

Mr. KAUFMAN. On the subject of what data is needed

Chairman LAFALCE. Yes.

Mr. KAUFMAN. It is very important to think about the purpose.

Ms. WALTERS. Exactly.

Mr. KAUFMAN. If the purpose is, is the insurance industry, generally, overcharging for all liability coverages, broadly speaking, the financial statement provides information on that subject. It provides premium income, it provides some income on investment income.

Chairman LAFALCE. But, if you are a daycare owner, you do not care whether somebody is overcharging or not overcharging in general. You are concerned whether they are overcharging you.

Mr. KAUFMAN. That is right. If you are a particular one of the 1,100 classes. Most of you care about, and the question is, is that class being over or undercharged, then you would need information from the statistical plan that will give you premium and claim information for that particular classification.

Chairman LAFALCE. Do the statistical plans give you premium information or rate information?

Mr. KAUFMAN. They give rate and the aggregate exposure.

Chairman LAFALCE. What is the difference between rate and premium?

Mr. KAUFMAN. Like $1.00 per pupil times the number of pupils. I forget what——

Ms. WALTERS. The statistical plan does not actually contain rate information. The statistical plan information—insurers report to ISO on a unit transaction basis. That means every time a policy is written, every time a loss is paid, every time a reserve is changed, we get a report from the insurance companies. That information that is reported is written premium. We get paid losses and the loss reserves and the allocated loss adjustment expenses from insurers.

We aggregate that data and we produce exhibits that either show historically, what the results have been, and we use that data base to develop our actuarial analysis of what future rates should be, given the loss experience it has developed.

So the statistical plan does not tell us what the rates are, but it tells us what premium was written for each of the policies that was provided.

Chairman LAFALCE. Mr. Angoff.

Mr. ANGOFF. Mr. Chairman, if you would permit me, I would like to get in just a short plug for another bill, because something has just been said here which, I think, has never been said this baldly. Maybe this organization, the ISO just said that paid losses do not matter. What they do is they look at those paid losses and they do certain calculations on top of those paid losses called loss development trending and a number of other things that enables them to come out with a so-called advisory rate which, then, everyone else in the industry is free to follow.

The reason they can do that is that they are substantially exempt from the antitrust laws.

Now we do not object to ISO' saying that paid losses do not matter and doing their own manipulation of paid losses. But what we do object to and what I think is a big reason the rates have gone so crazy over the last 2 years is that ISO's judgment, Mavis' judgment and, the other people's judgment who work there is substituted for the judgment of each individual company. And if each company looked at those paid losses and then made its own judgment on the basis of those paid losses, how much they should charge in the future, I think we would have a lot more competitive industry than just this one organization. ISO looks at these paid losses and then uses their judgment, and then everyone else is free to also use their judgment.

So that is why I think that the McCarran-Ferguson Act ought to be repealed.

Ms. WALTERS. May I respond?

Chairman LaFalce. Yes; how could I deny?

Ms. Walters. First of all, this is about the third time I was misquoted by Mr. Angoff. I am sure the record will be clear on this.

My point about paid losses is simply—I can support what Mr. Kaufman said. When you are looking at data and you are trying to analyze data, or answer a question, you have to focus on what question are you trying to answer. And then you go to the appropriate data source to help you get an answer to that question.

When you are looking at the relationship between premiums and losses, I said in that instance, paid losses are not sufficient to just look at paid losses, because an insurer writes an insurance policy, covers me for a year, and I may not have an accident until the last day of the year in my car and I hit somebody. Of course, that insurance company is not going to pay it that year. The insurance company may not have to pay that loss for 2, 3, or 4 years until that claim is litigated, until it is investigated, perhaps goes to trial, but ultimately, the insurer will have to pay that claim.

So, if the insurer just looked at the $300 I paid for my auto insurance this year, and saw it did not pay any losses and had zero paid losses, it would show, gee, they made a $300 profit on me.

However, when they pay that claim of $25,000, 4 years from now, clearly that is a different picture.

In evaluating the propriety of premium, the relationship between premiums for a given period and losses for a given period, you must look, not just at the paid losses, but at the losses you will ultimately have to pay, the liabilities you have already incurred because you have already charged that policy. You have got to look at all those liabilities to get a proper matching. It is what accountants call the matching principle. You have to look at the liabilities that match up with the premiums that were reported. That's the context in which I said paid losses were not enough.

Chairman LaFalce. A brief rebuttal to the rebuttal for 1 minute, then we are going to go on. Mr. Angoff.

Mr. Angoff. No more than 1 minute.

But how much you are eventually going to pay out is a matter of judgment. Assuming everyone has got the best of intentions, how much you are going to eventually pay out, that is, the ultimate incurred, are guesses. And what happens today, is ISO does the guessing for the industry. What we need is for each company to do its own guessing.

Ms. Walters. Oh, that is not correct at all. ISO is not in the slightest involved in estimates of incurred but not reported losses.

And by the way, history demonstrates, the historical fact shows that what Mr. Angoff just said is way off base. The amount historically, and we will make this available to this committee, historically the amount that insurers have held in reserves has proved to be insufficient, not overestimated, but has proved to be insufficient.

In 1976, total industry reserves were $47 billion. By the end of 1985, $57.8 billion was still necessary to pay those losses. Loss reserves were totally understated, not overstated.

Chairman LaFalce. The whole subject of loss reserves can be manipulated so easily by proponents or opponents of either side.

Ms. Walters. No; historical data cannot be manipulated.

Chairman LaFalce. Well, the fashioning of that data can be. The use of that data can be.

Mr. McDade. Would you yield?

Chairman LaFalce. Mr. McDade, let me just ask one more thing. You had said that you had given Congressman Rodino all the data that I have been talking about.

Ms. Walters. I do not know all that you have been talking about, but he did——

Chairman LaFalce. Well, that is what you said.

Ms. Walters [continuing]. Request for, I cannot recall now, about five or six lines of insurance, OL&T, manufacturers, and contractors, product liability, whether we could break down the premiums and losses and show the loss——

Chairman LaFalce. Well, I am advised by counsel that the information provided was not on just "paid losses." It was "paid losses" mingled with allocated loss adjustment expenses for products liability only.

Ms. Walters. No, no; we had it for OL&T and M&C. We had it for several.

Chairman LaFalce. All right.

Ms. Walters. We may have just given you products.

Chairman LaFalce. And that ISO told Congressman Rodino's subcommittee that they could not break out "paid losses."

Ms. Walters. The allocated loss adjustment expenses, I guess, were reported in with the paid, because they are directly related to an integral part of the loss payment dollars. So we could not take out the allocated, but we could take out everything else.

Chairman LaFalce. So, we did not have the pure "paid losses" either there. All right, it is important because I was led to believe that we did have the pure "paid losses" there, and again, we did not.

And how one allocates loss adjustment expenses is a separate subject, too.

Ms. Walters. No, no; allocated loss adjustment expenses are, specifically, defined as the expenses that are directly related to a specific claim, the investigation settlement or defense.

Chairman LaFalce. They define it that way, but how do you determine whether it is.

Ms. Walters. Well, obviously, the insurers who are investigating or defending a specific claim and go to—whether you go to trial or what, you know what your legal expenses are, you know what——

Chairman LaFalce. Well, what about your overall administrative costs?

Ms. Walters. That is unallocated. No; well, the other expenses that cannot be allocated to a specific claim but are related to the claims settlement process are called unallocated loss adjustment expenses. All other expenses such as premium taxes, general administrative expenses, commissions, et cetera, are not in this at all. They are separately identified.

Chairman LaFalce. See, the reason I have to go into this with such specificity is because of the last closed claims study that you made. And to my knowledge, the last closed claims study you made was 1978, correct?

Ms. WALTERS. No; 1976, I believe. The product liability closed claim study I think was in 1976.

Chairman LAFALCE. No; you did not do it in 1976. As I recall, you did it in 1977-87.

Ms. WALTERS. I cannot remember.

Chairman LAFALCE. That was the last time.

Ms. WALTERS. OK.

Chairman LAFALCE. We worked together on it. And I am concerned that we have not had a closed claims study since that time, and I am also concerned because although everybody—almost everybody—who came before my committee said that there are 1 million claims being brought per year.

Ms. WALTERS. You recall I never said that, Mr. Chairman.

Chairman LAFALCE. That is why I said almost everybody. Representatives from the insurance industry did, the Insurance Information Institute did, major companies did, and their major advertising did, and then after your closed claims study, you came in and said——

Ms. WALTERS. Or even before.

Chairman LAFALCE. Right. That it has been exaggerated; that information given to you by the Insurance Information Institute, that information given to you by major insurers, that information contained in advertisements of major insurers had been exaggerated by approximately 800 percent.

And also with respect to the amount of the awards, the severity as opposed to the frequency, on the basis of your closed claims study, as I recall, the amount actually paid out on average per claim was not $1 million, but it was a little over $3,000, between $3,000 and $4,000, $3,382, something like that.

Ms. WALTERS. I have not looked at it in years.

Chairman LAFALCE. Correct. OK, fine.

Ms. WALTERS. I will accept your——

Chairman LAFALCE. My point is, Ms. Walters, there was such a vast discrepancy between the perception of reality and the reality itself at that time, as proven by your closed claim study. I am most concerned that we have not had a closed claims study since that time, if for no other purpose than to determine whether the perceptions of reality that are being created today, or attempting to be created today, bear closer relationship to reality itself than they did a decade ago.

I am also concerned, not only that you did not have any closed claims study, but that now, you are going to have a closed claims study which, in my judgment, in comparison to your closed claims study of 10 years ago, is grossly inadequate, deficient, and almost preordained to come up with the type of result that might be desired.

Before I ask you to comment on that, I am going to ask Mr. Cerone if he would care to comment on that because, Mr. Cerone, I read an article where you raise doubts regarding the legitimacy of the ISO study.

Mr. CERONE. I did not write the headlines.

The question was—the context the question was in was whether or not the ISO study coming out would provide for the buyers and sellers of insurance the cost of tort reform, or the value of tort reform. And I said that I thought it would have a difficult time because it would be attacked on the issue of, well, is ISO an advocate of one side or the other. And it seems to me that has been a problem in the efforts to reform and to come up with a quantification. And that there have been, whatever report has been published is going to be criticized, and my indication there, was that ISO, because of the perception that it's aligned with the insurance industry, that that is the issue.

Chairman LaFalce. Aligned is not the exact word. It is owned by the insurance industry legally. I mean the various insurers own a portion of ISO. So we do not have to use the word aligned.

Mr. Cerone. My comments there were though, that the energy is going into the study, that it was subject, because of that relationship, to attack on credibility. And I do believe that everyone is trying to——

Chairman LaFalce. Mr. Delfico or Ms. Ekstrand, your office has made come comments regarding the probable credibility of the present closed claims study that ISO is undertaking and has not undertaken since, approximately, a decade ago, which again disturbs me no end. What are your comments regarding the closed claims study they are presently undertaking?

Mr. Delfico. Our primary comment was a question of independence of the people doing the analysis. In any study we do, we would like to have people not involved with the outcome do the analysis. And we suggested at the time——

Chairman LaFalce. Well, it was not just independence. Was it not much more than that?

Mr. Delfico. Well, that was the bottom line. It was, basically, we were questioning the independence of the——

Chairman LaFalce. Well, was it not the methodology too?

Mr. Delfico. Yes; the methodology is a problem; yes.

Chairman LaFalce. Oh, there is a difference between independence and methodology.

Mr. Delfico. Well, OK.

Chairman LaFalce. I mean, independence, you know, might go to the integrity of the individual or individuals. Methodology might go to something else.

Mr. Delfico. Yes.

Chairman LaFalce. What problems might you have, Ms. Ekstrand, with the methodology?

Ms. Ekstrand. Basically, ISO is asking claims examiners to fill in what they think tort reforms would do to settlement amounts after they have already filled in what the settlement amounts actually were, or what they perceive they would be, when an open claim gets settled.

Chairman LaFalce. And this is going to be called a closed claims study?

Ms. Ekstrand. Some of the information will correspond to a closed claim study because the first bit of information will be about what a claim was actually closed for. But my understanding is that the effect of tort reform would be based on the claims examiner's opinion of what the claim would be closed for had tort reform been in effect in their State.

Chairman LaFalce. That is a guess, is it not?

Ms. Ekstrand. I think that ISO concludes that——

Chairman LaFalce. Then why call it a closed claims study if it is a guess? You should not call it a closed claims study then.

Mr. Angoff.

Mr. Angoff. I would just like to point out that even the Department of Commerce has had, essentially, the same criticism of the ISO study.

Chairman LaFalce. Even this Department of Commerce?

Mr. Angoff. That is correct.

Chairman LaFalce. I cannot believe that.

All right, Ms. Walters, your chance.

Ms. Walters. To the question of the methodology of the study, we believe that the study design, this is called a claim file data analysis. As I said in my prepared statement, we are looking not just at closed claims. We are also going to be examining some open claims, some mature open claims. So, we will have an analysis that is more responsive to current conditions.

We believe that we have learned a lot. We, as a staff, as an organization, have conducted more closed claims studies, more claim analysis than any other organization. We have learned——

Chairman LaFalce. The last one being 10 years ago.

Ms. Walters. We learned a great deal from——

Chairman LaFalce. Which says that the underwriting judgment which was based upon a frequency of 1 million was overstated by 800 percent.

Ms. Walters. No, sir; that was not the conclusion of the study. That was not the value that other public policymakers and other studies found from that one.

But, be that as it may, we have refined this study analysis to a far greater extent than we ever have before. We believe that the questions that are being asked are going to be very, very helpful, not just to insurers and not just to technical staff, but to public policymakers, legislators, insurance departments, and anyone else who wants to review it.

Chairman LaFalce. Now, Ms. Walters, you and I might be able to sit down with your closed claims study and say, OK.

Ms. Walters. It is not a closed claims study, Mr. LaFalce.

Chairman LaFalce. Oh, it is not?

Ms. Walters. I told—this is the third time. I will try again.

Closed and open claims, we are going to be looking at both claims.

Chairman LaFalce. I know you said that, but is it not being referred to, and did you not refer to it as a closed claims study you are going to conduct?

Ms. Walters. No, sir. No.

Chairman LaFalce. I thought you had.

Ms. Walters. No; a claims study, I called it a claims study.

Chairman LaFalce. Ah.

Ms. Walters. And we are calling it a claim file data analysis, and it is true some of the questions that are being asked are going to be directed at the best person who possibly could evaluate that claim. In most instances, it will be the senior claims expert who was involved in settling the claim to begin with. That person is going to be asked to fill out the claim form which is rather extensive and it has got a lot of questions in it.

And also, as part of the questions, will be asked to reevaluate the claim in light of the specific tort reform which may have been enacted in one of the States, in the specific State where that file is being prepared.

Chairman **LaFalce**. It seems to me that you are preparing this claims study then, probably as a means to go about justifying some changes in tort reform that have taken place or are going to be taking place.

Ms. **Walters**. No, sir; we are not trying to justify anything. We are trying to——

Chairman **LaFalce**. Why are you doing this type of study then, rather than a really legitimate closed claims study?

Ms. **Walters**. I would suggest, Mr. LaFalce, one of the things we learned by doing, as you call it, really legitimate closed claims study, is that it is highly limited in its value.

Chairman **LaFalce**. I would think it would be much more valuable.

Ms. **Walters**. No; a closed claim study totally looks backwards, totally looks backwards. Most of the tort reforms which——

Chairman **LaFalce**. Well, it looks backwards maybe over the past 8½ months——

Ms. **Walters**. Oh, no; I beg your pardon; 10, 11, 12, 13 years, because claims that are closed in any given timeframe, and particularly we are talking about the long tail lines here, we are talking general liability. It is going to represent a very tiny fraction of claims that were newly arisen and closed quickly. It is going to contain a vast amount of claims that were opened and whose liability was incurred 7, 8, 9, 10, 11, 12 years prior. So it looks back really a lifetime ago in terms of the current legal environment.

By looking at a current, or less current policy year fairly close and looking at closed claims as well as open claims, we get a better feel for the current environment.

Chairman **LaFalce**. You are going to give us a snapshot.

Ms. **Walters**. That is right. That is all——

Chairman **LaFalce**. You are not going to give us anything from before, you are not going to give us anything in the future. It is just a snapshot right now.

Ms. **Walters**. That is right, which is exactly what any closed claims study is.

Chairman **LaFalce**. If anything, it is going to be limited in its utility. It would seem to me that all it could be useful for is the marketing effort by III.

Ms. **Walters**. Oh, not. It is not——

Chairman **LaFalce**. Oh, oh, you watch the marketing effort that is going to be made by III, the Insurance——

Ms. **Walters**. No, sir; in fact, any claims study, even a closed claims study is only a snapshot in time. So that——

Chairman **LaFalce**. The question is how long a period of time?

Ms. **Walters**. That is correct, and do you want to look at ancient history or do you want to look at the current environment?

Chairman **LaFalce**. You cannot just look. If you came in as an outside actuary and said, let us just look at that one simple period in time and that is it. I do not think people would say it has very much utility.

But my counsel also advises me that my 5 minutes has expired. [Laughter.]

And so Mr. McDade.

Mr. McDADE. John, thank you very much.

Let me ask you a question about this retrospective study that you were just discussing. Do you not have a lot of that information already?

Ms. WALTERS. The information which is routinely kept is information on premiums, losses, number of claims, and loss ratios. The special claims studies that we were referring to get at information which is not routinely captured in data reporting systems. Information that is in the claim file, as the gentlemen from M&R were talking about, but is not needed by insurers to conduct their normal, everyday business transactions.

Over 90 percent of claims are settled long before you go to trial. Most claims are settled without even a lawsuit being filed. So, that there is not a lot of information in claim files about was a lawyer involved, what were the economic damages, what were the noneconomic damages, joint and several. There is nothing in there. This is a matter of negotiation between the injured party and the insurance company.

Mr. McDADE. I understand, but to justify your rates in the various States with the various State commissioners——

Ms. WALTERS. Right.

Mr. McDADE [continuing]. You present a retrospective or historic package.

Ms. WALTERS. Not entirely. The actuarial analysis in terms of justifying rate changes for the future is really a prospective analysis. We look at what we have which, of course, is the data of the most recent past.

Mr. McDADE. Right.

Ms. WALTERS. That forms the foundation, but that all has to be adjusted to future timeframes through what we call lost development and trend to approximate the loss level that we anticipate will prevail at the future time when the rates are being charged.

For example, if you are charging—going to make rates for 1988——

Mr. McDADE. Based on past experience though.

Ms. WALTERS. The foundation, and then you adjust that upward, forward.

Mr. McDADE. Yes; in some fashion then.

Ms. WALTERS. That is correct.

Mr. McDADE. And you referred to something that said that your reserves were going down dramatically?

Ms. WALTERS. No, sir.

Mr. McDADE. What was the paper that you——

Ms. WALTERS. The charge is often made and the suggestion is often made that these loss reserves, these estimates of future liabilities, the implication seems to be, well, companies just inflate those arbitrarily and they are always too high.

Historically, they have been too low. In 1976, industry-wide loss reserves were established at $47.1 billion. That was the total estimate of how much they would have to pay on losses where the incident has occurred but they have not paid them yet. By the end of 1985, $50.2 billion had already been paid out. Now they estimated, ultimately, they would have to pay $47 billion. By the end of 1985, $50.2 billion had already been paid and an additional $3 billion was still being held in reserve because there were still some of those claims that had not been settled yet.

Mr. McDade. Let me ask you a question then. During that same period of time when you are painting this picture of an underestimation of reserves based on future liabilities, insurance profits rose dramatically, did they not?

Ms. Walters. Actually, 1976 to 1985 was a complete cycle. From 1976 to about 1979, profitability increased. Beginning in 1980, the profitability took a nose dive and was significantly——

Mr. McDade. Well, in the period I thought that you are referring to, I mean I have people come into my office who have just had, without any claims, their insurance doubled or in some cases, was canceled. And they want to know why the insurance industry's profitability has increased dramatically, at the same time that they have been good citizens, to the extent that they have not been negligent, if that is a definition of good citizenship, and there have been no claims filed.

Yet, their particular insurance, in some cases, was outright canceled; in other cases has increased, doubled, tripled, et cetera. What is your response to that?

Ms. Walters. Oh, Mr. McDade, this is the most commonly asked question and in a sense the most difficult one to explain to people.

All insurance is prospective, and it is true, many insureds, whether you are talking personal, auto, or homeowners, or business in the most recent case will say, well, gee, I never had a claim but yet my rates have gone up. Why.

I suggest the answer is the same as those of us who have to pay more each year for our auto insurance even though we do not have accidents. Not everyone will have a claim. We cannot rate each person or each business solely on the basis of their own loss experience. If one could do that, of course, we probably would not even need insurance.

Mr. McDade. The industry is showing enormous profitability or it was until 1980 when you said it began to trend down.

Ms. Walters. Well, it was not enormous. It was acceptable and then trended down to totally dismal. But the point is how we rate, that is really the question.

Mr. McDade. What was it in 1985 and 1986?

Ms. Walters. 1985 was a return on net worth of 3.9 percent when the Fortune 500 were earning 11.6 percent.

Mr. McDade. Well, we have different figures, and I do not really care to get into a discussion back and forth on the figures.

Ms. Walters. But let us answer the question that you really are concerned about, which is why does this consumer, why does this person have to pay more when he did not have a claim.

And the way rates are determined, generally, is we group similarly situated individuals or similarly situated businesses into—that is what we were talking about before—classifications. Classifications are mean to define, like businesses or groups as I say, or automobiles. And we look at the experience of all of these insureds who share those same characteristics. And on the basis of the experience of those similar insureds, rates are adjusted upwards or downwards.

So, you certainly do not expect and not everybody who is in that class will have claims. But the ones who do will drive up the rates for the rest of us who do not have claims.

Chairman LaFalce. Let me just interrupt for a minute, because I am going to have to go and turn this over.

But is it not true, Mavis, that it is generally accepted that the industry was engaging in some poor cash-flow underwriting practices?

Ms. Walters. And drove rates down, absolutely.

Chairman LaFalce. And that probably means that they were not charging adequate rates——

Ms. Walters. That is correct.

Chairman LaFalce [continuing]. During a certain period of time. But then they made up for it with a vengeance. In other words, perhaps they should have increased their premiums 40 percent, and they may well have increased their premiums 400 percent, when they could have just increased rates 40 percent. Do you have any judgment on this that you would care to share with us?

Ms. Walters. Well, I cannot judge on an individual policy basis, but you have described what generated this problem to begin with.

Losses were not going down during this period 1980 to 1986. Incurred losses, the things for which insurance pays, have steadily been going upward. But yet, when you look at the prices charged in the marketplace, they were pretty much flat if not dipping down a little bit.

Then, when you got to the end of 1984 when insurers' balance sheets showed they were generating operating losses, they started to realize that this madness can no longer continue. But when they looked at where they were with the premiums here and losses that those premiums were supposed to cover were here, it took substantial and high premium adjustments not to recoup that past losses. You cannot get back money you have lost; it is gone. But to get premiums to the level where they will at least match the losses they are going to have to pay in the future——

Chairman LaFalce. In the aggregate, would a 40 percent increase have brought them to where they should be?

Ms. Walters. No; I do not think so.

Chairman LaFalce. As opposed to a 400 percent?

Ms. Walters. As I said, for general liability the premiums were at the end of 1984——

Chairman LaFalce. Did you not say in some public forum, at one occasion, that you thought that, perhaps, insurance companies could have come up to where they should be with a 40 percent aggregate increase? Instead, many insurance companies came in at 100, 200, 400 percent, for example.

Ms. Walters. If I had said 40, it was averaging it over all lines of insurance, including personal, and private-passenger auto, and homeowners. But private-passenger auto and homeowners should not have had increases to take care of the GL losses.

Chairman LaFalce. I am going to ask Mr. Lancaster if he would come and chair the hearings for the duration of the hearing. I ask him to carry it on so long as any member has a question he desires to ask.

If there are no questions, and I have not yet returned, I ask that he recess the hearing until such time as I return, which should be approximately noon. Will this cause any inconvenience to any member of the panel?

Ms. Walters. I have to be on a train to Philadelphia.

Chairman LaFalce. At what time, Mavis?

Ms. Walters. I have to be on the train by 3:00, but I have got to go back to my office to get all my materials.

Chairman LaFalce. Oh, well, that is no problem. We will not go more than between 12:00 and 1:00.

Ms. Walters. OK.

Chairman LaFalce. You will have plenty of time. Thank you, Mr. Lancaster.

Mr. McDade. Let me turn my attention, if I can, to the panel from the GAO who is here, who has been into this complex and complicated area and has done some, obviously, good work.

You have heard a lot of the dialogue taking place, and what I want to try to ask you—and do not take the question too formally because I want to really have a conversation with you more than a question—is, obviously, the committee, this committee and other committees in the Congress are attempting to gather information that will enable us to make proper judgments about public policy with respect to this crisis, which is a crisis in the Nation.

You have had some conversation about access to information, about the data base that you might need to get in order to acquire the information to be able to intelligently say to us, we feel that we have been able as representatives of the Congress to go out and look at the accounting problems, et cetera, of the industry, and we are prepared to report back to you.

Now, what I am trying to ask you is you have done it in medical malpractice insurance. Talking about the whole industry is an enormous kettle of fish, obviously, and the accounting practices that they all engage in and all the rest of it. What I want to know is what do you need? Can you, if requested by the committee, by individual members, gather the data that we need to look at where this entire economic procedure is going; have you got the authority to do it now? Have you got the means to do it now? Have you got the accessibility to information that exists in public forum, primarily through cooperative efforts, if possible, to be able to come back in a reasonable period of time and say, we feel confident we have got the information that is necessary? We have looked at how this whole problem has come about and are able to make recommendations to the Congress about what, if any, activities we can take at the national level to solve the problem.

Now that is a lot of words at you and I do not expect you to answer yes or no. I would like to get educated about problems, and I know you encounter enormous problems every day, but you are our auditors, you are our accountants, you are our experts. Can you come back to us with a meaningful study on this whole problem?

Mr. Delfico. I would like to answer that question directly.

Mr. McDade. Please. And may I encourage and say that I am really not trying to ask a question. I am trying to engage in dialogue with you to find out if you have the assets that you need, if you can come back to us, if you want to make recommendations to us about things that you would need to do or know, et cetera, I think the committee would be interested in knowing that as well.

Mr. Delfico. I understand.

I guess the first thing I would suggest is that with all the data discussion that has been going on today, I find it difficult tracking what questions we need to answer with all this data. And I think that is the first thing we have to do to answer your question.

If we had a specific set of questions that you were interested in answering, for example, the one we tried to address today was, basically, do tort reforms have an impact on premiums? That is a question. There are a number of other questions you could ask, each one of them drives different data requirements.

Mr. McDade. Yes.

Mr. Delfico. So, what we did is we took that question. We said how do you answer that question over time, and our approach was to use a statistical model, or at least develop a statistical model that could answer that question.

Our next step was to ask——

Mr. McDade. Let me back you up one question.

Who would be the guru that we could say what are the appropriate questions to ask in this particular instance and could ask you all the appropriate questions necessary to develop the data and make recommendations?

Mr. Delfico. Well, we could work with you and your staff to develop questions. These are, basically, policy issues that you would want answered, and we could help you develop questions, and subquestions that would drive——

Mr. McDade. Do you feel there is a sufficient degree of competence within GAO itself to understand the complexities of an enormously, and obviously, difficult problem?

Mr. Delfico. I would say so, yes. This is not a new area for us. We have been in it for awhile.

Mr. McDade. I would think you have.

Mr. Delfico. Recently, though, we have been in it with great vigor I should say.

Mr. McDade. Right.

Mr. Delfico. We have a number of groups working in this area. So we could probably get our heads together and help the committee define the questions. But the real concern on my part is, first of all, resources to do this kind of thing. We have, I would guess, ongoing at any given time, 5 and 10 separate studies on insurance issues right now.

Mr. McDade. Yes.

Mr. Delfico. In my group only, I have got four going on at one time dealing with separate questions. So we are spread pretty thin.

Second, we do not have access to data. We just do not have the ability to get in to see insurance industry data. However, they have been very cooperative in our medical malpractice work in giving us information, but we do not have——

Mr. McDade. Is that the only role model you have, the medical malpractice?

Mr. Delfico. So far, that is the only role model we have, and we can get into detail on what data was available. Ms. Kladiva did that study for us.

Mr. McDade. And, of course, if it became important to talk back to us about lack of cooperation, there would be remedies that we could consider in that eventuality. Would that be correct?

Mr. Delfico. Yes; that would be correct.

Mr. McDade. Let me ask you a question because assets are always an enormous problem, and this is a huge problem. What kind of—and I am assuming you are talking manpower shortage.

Mr. Delfico. Yes.

Mr. McDade. Any kind of estimate or could you furnish some kind of estimate of the manpower that would be necessary for you to be able to try to tackle the problem with sufficient assets? Could you do that, or do you know offhand?

Mr. Delfico. Offhand, I would have to take a look again at, what the specific questions you would want answered in order to come up with that.

Right now I am guessing, but I think we have about 10 staff years worth of effort going into insurance-related issues right now. I doubt if that will be enough to answer the questions you are dealing with.

I gather from what you said, this is a pretty broad issue and there will be a series of questions we need to answer. It will cut across our jurisdictional lines in GAO also, so I am only speaking for one group.

Mr. McDade. Yes.

Mr. Delfico. But we do have other groups that deal with the profitability issue, and we have——

Mr. McDade. That are already in existence?

Mr. Delfico. Yes; they are in existence and they are doing work in that area and have testified on numerous occasions on that issue.

Our work in malpractice, product liability, and general liability is by comparison relatively new. We started about a year ago developing expertise and gathering data in this area because of the insurance crisis and the requests we have got from Congress. We have had a number of them in the past year.

Mr. McDade. And do you feel that in those areas where you are already working for this year that you have developed a cadre of expertise and necessary manpower, et cetera, to get into those areas?

Mr. Delfico. Yes; we have.

Mr. McDade. Please continue. I do not want to stop you. I want to listen to you.

Mr. Delfico. The bottom line, basically, is we would have to work pretty closely to develop a design for the future, a design for the studies we would do for the future. That would drive our resources. Then we could come back and tell you we do not have enough people, or we do have enough people.

Mr. McDade. How many committees, House side only let us say, are requesting information from you on that?

Mr. **Delfico**. We are doing work for the Commerce Committee right now and we are doing work here for you and for individual congressmen.

Mr. **McDade**. And is there a great deal of overlap involved in—what I am trying to get at is there a possibility of coordination in there?

Mr. **Delfico**. I would highly recommend that if you could, to have a coordination amongst everybody in the House. If you were going to request a major study, that would help us enormously, too, to get the resources.

Mr. **McDade**. Is there any way that you could, assuming that we were able to provide you with the necessary resources to take a good, hard look and come back and recommend, any way you could put a timeframe on how long it would take you to complete your activities?

Mr. **Delfico**. Well, to do what we had proposed here in this testimony, this may not be acceptable in your timeframe, but we think it is going to take 3 to 5 years to gather the data on product liability and general liability to come up with an answer to the question of whether or not tort reforms are having an effect on premiums.

Mr. **McDade**. On that one issue.

Mr. **Delfico**. On that one issue. That is because, as each of the panelists has mentioned, a lot of the costs are incurred not in a given year, but over time. And we will have to develop rather sophisticated methodology for linking these costs over time and including the time lags and the payouts to the premium rates, and it is just going to take time to gather the data.

Mr. **McDade**. Well, as far as I am concerned, the larger question that affects me, which is John Q walking into my office and saying, hey, what happened. I did not have an accident. They doubled, tripled, or whatever my insurance, or canceled it. I am sure that would be one of the questions that we would want to try to address. Have you had occasion to look at that at all yet?

Mr. **Delfico**. Not that detail, no; we have not. We have been working with pretty aggregate level questions.

Mr. **McDade**. Yes; so there would not be any way to estimate any kind of a timeframe on something like that.

Ms. **Ekstrand**. We do have one study which will be out next fall that will take a broad look at the availability and affordability of commercial general liability across a wide variety of businesses. So we should have information across a whole variety of people that are just like your constituents to find out across the board just how big were those rate increases and how severe was the availability problem. So we do have one study that is going in the direction that you are thinking about that is ongoing right now.

Mr. **McDade**. OK. Is there anything else that you want to provide, any other information that you want to provide to me?

Mr. **Delfico**. That is it. Basically, it is going to take a while and the cost, resources, and again, I want to reiterate, you really have to decide on what questions you want answered before you go out and gather the data.

Mr. **McDade**. I wanted to ask one question. Why are the data so difficult? Is it not on file in public bodies, States, commissioners, et cetera?

Mr. **Delfico**. Yes; some of the data is on file.

Mr. **McDade**. But not what you need to get your job done?

Mr. **Delfico**. Well, depends on the detail. If you want some very detailed information, maybe even the insurance companies do not collect it in that manner, and you would have to reconstitute the data in the claim.

Our experience with the closed claims work that we have done in medical malpractice indicates that the data are there but it takes some time to go and collect it and put it in the form you need it in.

Mr. **McDade**. Yes; a lot of times an insurance company does not want to disclose the verdict of the settlement, et cetera. They have got all kinds of claims. There are a million contingencies.

Mr. **Delfico**. Right; and the confidentiality issue.

Mr. **McDade**. Yes, yes.

Mr. **Delfico**. That one would have to consider.

Mr. **McDade**. OK, if anybody wants to contribute to that, I would appreciate it.

Yes, please.

Mr. **Angoff**. To find out the effect of tort reforms that have already been enacted, I agree with the estimate of 3 or 5 years. But you could do a much simpler and actually, a study I think open to much less objection and just find out in the past, in the recent past, how much, for example, have companies actually paid out for noneconomic damages. How often have they paid out, say, more than 250,000, or how much have they actually paid out for punitive damages. What has been the effect of joint and several liability in the recent past.

The State of Texas, the Texas Insurance Commission did such a study, and they just looked at 3,300 claims over the last 4 years and—I mean there were problems with it, but they got it done very quickly, I think within 6 or 8 months, and I think that type of study really could be, fairly easily, done.

Mr. **McDade**. Are they the first State to do it?

Mr. **Angoff**. Yes.

Mr. **McDade**. And it took 6 to 8 months?

Mr. **Angoff**. Maybe a tiny bit more, but just about that; yes.

Mr. **McDade**. But it represented a pretty good rule of thumb as to the effect of the tort claim laws, et cetera?

Mr. **Angoff**. Absolutely.

Mr. **McDade**. Does anybody disagree with that?

Ms. **Walters**. Yes, sir; the Texas closed claim study was in development, it was a lot longer than 6 or 8 months. I think the gathering of the data may have lasted only for that time period, and it was very, I am going to say provincial, unsophisticated.

But to a large measure, some of the information that is being talked about is going to be captured in the claim file study that we are conducting.

Mr. **McDade**. Ms. Walters, let me ask you this question. Do you think the Texas study was a useful study?

Ms. **Walters**. I think it—yes, sir. I think it does have some use and value.

Mr. **McDade**. The question you had was the length of time, whether it was 6 months or longer to get——

Ms. **Walters.** Right; and as you might imagine, there were a lot of political considerations involved in their doing the study. Florida also has a study underway and, as I say, we have a study underway that is more deliberate in its study design, but I think, ultimately, is going to provide a great deal of useful information.

Mr. **McDade.** When is that study due?

Ms. **Walters.** Our estimate is it is going to take 18 to 24 months, so we share the concerns of GAO that when you try to do a rigorous analytical study, you want to do it right.

Mr. **McDade.** I want to come back to this side.

Mr. **Angoff.** Three points. With respect to the Texas study, we worked closely with the State of Texas and nothing was even thought of until the beginning of 1986. I mean they really did it phenominally quickly. Questions were not even thought up, did not even begin to be thought up until the beginning of 1986.

Mr. **McDade.** Yes; I have a statement here that says that survey forms with instructions were mailed in June 1986.

Mr. **Angoff.** Yes.

Mr. **McDade.** Is that the accurate date?

Ms. **Walters.** Right; that is what I say. The collection of data may have been just about 6 months, but that——

Mr. **Angoff.** And developing the questions was just a few more months. It went very, very quick.

Mr. **McDade.** It was completed in 1987.

Mr. **Angoff.** February 1987.

Mr. **McDade.** Was done rapidly. What was the date?

Mr. **Angoff.** February 1987 was when it came out.

Mr. **McDade.** So it was done in less than a year.

Ms. **Walters.** Yes; but the time—but the development, the sending of the survey form followed a lengthy period of time of a lot of people working. We worked very closely with them as well, and shared our expertise because we have done——

Mr. **McDade.** Well, it would not take as long to do it in another State having done it and gone through it, would it? I mean having developed the questionnaire.

Ms. **Walters.** To duplicate the Texas study, it might not. But as I said, I think we are doing one which we believe will be of more value and have more——

Mr. **McDade.** I yield my time, Mr. Chairman.

Thank you all very much.

Mr. **Lancaster** [presiding]. Mr. Hayes.

Mr. **Hayes.** Thank you, Mr. Chairman. I feel that I must compliment the chairman of this committee for having scheduled this hearing in such an important area of everyday life of human beings here.

I guess, categorically, you can put me in the position that Mr. Angoff referred to as one of these common folk who has been a victim of rate increases by insurance companies. I do not want to get into ancient history though, do not want to burden you with that.

But we have got people today, who are being victimized by what is categorized as insurmountable increases in insurance rates. There are two areas in which I am vitally concerned about. One area is the automobile liability insurance rates and the other area which has been referred to as malpractice insurance, in particular, because I have had physicians in my district, at least two or three of them that have said they are going to find some other source of income because they cannot afford to pay the skyrocketing insurance rates.

Another question is that it appears from the discussion—and I thought this may be necessary before but I did not understand just exactly the procedures—does it make logical sense to hold up rate increases of insurance until studies are completed to justify those rate increases? It seems to me, I have not seen where Aetna, or Allstate, that is Sears, or GMAC are threatening Chapter 11's, or bankruptcy.

Yet, they are permitted to increase their rates. I have a granddaughter, for example, who I had to help last year to get insurance for which she paid more—now almost as much—for the monthly insurance premium than she does on the car note. That is in the State of Illinois. It seems to me so unfair.

It seems to me that we ought to think in terms of legislation that would require insurance companies to provide information. There is so much hidden. It seems to me they are not up front. I agree with what my colleague McDade said, that we need direct answers to the reasons why rates are being increased at such levels. And maybe at another time, I do not think it should take 4 or 5 years; that scares me. I have small businesses who go out of business in my area because they cannot afford the insurance rate that they are required to pay.

So, my direct question is, you have mentioned the tort reform and its impact on insurance rates. I am not clear from the answers that I have gotten as a member of this committee. In specific terms, what are those reforms that have direct impact on the insurance rates that cause them to rise? I need somebody to answer that question. Anyone.

Mr. **Delfico**. Well, in our work, Mr. Hayes, we have looked at tort reforms that have an impact on insurance premiums, and most have a negative impact or positive, depending on where you are looking from. And that is, they should reduce insurance premiums rather than increase insurance premiums. I think that is the purpose of tort reforms.

Mr. **Hayes**. Has it really done that?

Mr. **Delfico**. That is the question on the table. How do you determine whether it has done it or not. And, I think, in our testimony, in our analysis, it is really a difficult thing to do. There are many, many factors besides tort reforms that affect insurance rates. And you have to sort that out and determine what the impacts of each are.

Mr. **Angoff**. Congressman, we do have some evidence on that. In the State of Florida, they enacted five major tort reforms, and then, they also required the insurance companies to reduce their rates to take account of the savings that those tort reforms would engender. And one of the largest insurance companies, the Aetna, did a study in which they looked at 105 claims that they had recently closed, and they asked the question, what would be the impact on our payouts, and therefore on insurance rates if all five tort reforms were in the law during the entire pendency of these claims.

And those tort reforms were: limiting pain and suffering to $450,000; limiting punitive damages; limiting joint and several liability; getting rid of the collateral source rule; and requiring periodic payments of future damages.

And the Aetna's conclusion was that these would have absolutely zero impact on payouts and therefore insurance rates for general liability bodily injury.

I have got problems with that study, but that does not mean that all companies would come out with that result, but that is what the Aetna concluded in Florida.

Ms. **WALTERS**. I would like to comment on that, if I could, to see if we cannot get some more understanding about this subject.

The Florida proposals have a sunset provision of 4 years. The sunset provision is shorter than, or closely coincides with, the Florida statute of limitations, so this is the first area of concern. That no one knows for certain what will be the behavior of claimants and their attorneys, particularly, in what are likely to be large dollar claims which would otherwise be subjected to the caps. Is it not a possibility that, I would call it prudent behavior on behalf of the plaintiff's attorney to say why should we file this claim now while this law is in effect. Why do we not wait and see whether it is going to be—we have 4 years on the statute of limitations. Let us wait and see, is the legislature going to let it die or are they going to reenact the law. So, this is one area where we do not know.

Also, even in some of these concerns, joint and several liability is not—any changes in that doctrine are not likely to have an impact in personal auto or homeowners insurance where you do not really have deep pockets, and where the average homeowner or average automobile driver is not carrying huge amounts of liability insurance, but a moderate amount to protect what they think are their assets. So we do not expect there to be much impact at all in the personal lines of insurance, and even in the commercial lines of insurance when you look at the types of tort reforms that have been enacted.

I think, when we just think about it as reasonable, logical people, you must conclude that in most instances for most businesses, for most insureds, it is not going to be relevant. It is not going to have an impact. How many businesses purchase insurance of $1 million limits or more? A $450,000 cap on noneconomic damages, except under certain circumstances, there are loopholes quite wide in that, well, we will accept this, we will exempt that, will clearly only impact a claim that otherwise would have an excess of $450,000 of noneconomic damages. So that means you are talking about a claim that could have as much as half a million or close to a million dollar indemnity value that still may not be impacted by that limitation.

So these are the kinds of complexities in the tort environment, in the claim environment that make it very difficult for any of us, no matter from what prospective we come from, to evaluate or to predict what is the likely impact of this law.

Your question is an excellent one but it pointed out the very difficult problem that we are all wrestling with, whether it is insureds, public policymakers, or insurance companies.

Mr. **Hayes**. What are the rules or the yardsticks an insurance company would use, and I will take the one that is most common, that is automobile liability insurance, why would a place like Chicago have the rates higher in one area of the city than the other area? People who can least afford to pay have to pay higher automobile insurance than those who live on Lake Shore Drive in Chicago. Tell me what yardsticks do they use?

Ms. **Walters**. Actually, auto insurance and most kinds of insurance, particularly when you are talking about the personal lines, the costs of auto insurance are driven by two factors which are the average cost of the claims and the average frequency of claims.

It is just about universally true that when we examine the data, when we look at the data on auto claim costs and claim frequencies, areas with greater congestion, urban areas where there are a lot of cars, a lot of drivers, there are more accidents and the accidents are more costly because when you think about what are we paying for, what are auto claim costs, you are talking about repair costs to the auto which tend to be higher in urban areas. You are talking about bodily injury costs which tend to be health care costs, hospital costs which tend to be higher in urban areas. You are talking about when people are injured, wage loss which tends to be higher in urban area.

So, it is a rather consistent pattern that we see in urban areas where there is the increased likelihood of having an accident. And when you have an accident, the cost is likely to be higher.

Ultimately insurance is a financial passthrough mechanism. Insurers do not create high-risk drivers, but the insurance system does identify those areas where the costs are higher.

I might mention even in California, the highest rated in California happens to be Beverly Hills. But it is true in virtually every State that the cities have higher costs, therefore, higher insurance premiums than do rural areas.

Mr. **Hayes**. Thank you, Mr. Chairman.

Mr. **Lancaster**. Mr. Rhodes.

Mr. **Rhodes**. Thank you, Mr. Chairman.

Ms. Walters, I have an educational question I have to ask you. I think it is a fairly simple one.

When you calculate the loss ratio, when you talk about the losses that go into that calculation, are you including there, reserves and IBNR's?

Ms. **Walters**. Yes, sir; usually we always include—we use incurred losses to earned premium. So it would include both paid and all estimates of outstanding liabilities.

Mr. **Rhodes**. OK, now off that subject.

Ms. **Walters**. Right.

Mr. **Rhodes**. When you are doing your actuarial analyses of losses as it relates to premiums and so forth, do you adjust the losses to reflect amounts that are recovered by the insurer due to subrogation?

Ms. **Walters**. Our analysis of all our figures are direct, so it is prior to subrogation. That is the way we look at it in our statistical plan. And there have been studies done, on occasion, to see whether we get distortions in those results, and you do not, because as you might imagine, there is a lot of subrogation that goes on back and forth and back and forth among insurers.

The ISO data base, though, is a data base of aggregate experience for all the insurers who use us as a statistical agency. So, basically, it is a wash out; it does not distort our results.

Mr. RHODES. Again, in the same process when you are analyzing losses as opposed to premiums, do you take into account in calculating the losses claims that are paid by self-insurers?

Ms. WALTERS. No, sir; only the data of insurance companies. Self-insured, to my knowledge, do not have to report statistical data and do not report statistical data to any source.

Mr. RHODES. When you are analyzing a class then, losses as opposed to premiums in a particular class, your data is not complete. If you are looking at the potential risk within a class, you have to assume that there are some self-insureds involved in that class who presumably are paying claims.

Ms. WALTERS. Well, you are correct. When we look at the total volume of losses for a particular class of business or even line of business, it only reflects insured data. It does not reflect noninsured data, and that is a very good point, because, particularly for some of the problem classes like the governmental entities, the municipalities, cities, and counties, many of them, historically, for years and years have always been self-insured, like New York City and there are a lot of—I think Long Beach and a lot of large cities all over the country have never bought insurance, never wanted to buy insurance. They are always self-insured.

So that loss experience is not in the kind of data that any of us can look at.

Mr. RHODES. So that being true, you have to have a little bit of a fear in the back of your head that your analysis is not possibly, or is potentially not completely accurate as to the risk.

Ms. WALTERS. Well, no, sir, no, Mr. Rhodes; we are all right because we are compatible. We are looking at only an insured data base. We are looking at the premiums generated by insurers.

Mr. RHODES. Looking at the potential for a loss within a class.

Ms. WALTERS. That is correct.

Mr. RHODES. You do not have complete data on that?

Ms. WALTERS. We do not have 100 percent of the data, but what we have—with the exception of a few classes where it is outside the insurance mechanism—what we have is a pretty incredible data base and we are matching like things. We are looking at the risks for which a premium is collected and the losses which correspond to that.

But you are right, we do not have 100 percent of the data base.

Mr. RHODES. You cannot include that data because the data is not available to you.

Ms. WALTERS. That is right. They are not required to give it to anybody.

Mr. RHODES. It must be kind of frustrating to you not to be able to do your complete analysis because data is not available to you.

Ms. WALTERS. Well, we do not suffer from a lack of credibility for that.

Mr. RHODES. It was a dry observation.

Ms. WALTERS. I understand, I understand.

Mr. RHODES. Your statement of your ratio of paid losses to GNP, your comparison was kind of intriguing, and I would like to talk to you a little bit about those losses and losses in general, in analyzing that.

Can we break out losses in terms of how they came to be settled? In other words, a loss that was settled routinely, settled upon filing as opposed to a loss that was settled, say, after a lawsuit was filed but before judgment, lawsuits or claims that actually went to judgment; can you break out in that fashion?

Ms. WALTERS. No, sir; Mr. Rhodes. Routinely this is the kind of information which is not captured, but it is the kind of information that is going to be captured in our claim file data analysis that we are undertaking.

Mr. RHODES. Then I would like to suggest a different potential conclusion from the one that you drew. The conclusion you drew from the statistics that you presented was that there was some unidentifiable external force driving the losses, and you indicated, at least potentially, that driving external force is litigation, litigation explosion, the jury system, civil justice system. And I would like to suggest to you that we could consider since you cannot break those losses out, we could also consider that that experience came about because of the underwriting practices of the insurance industry in general, the types of risks that it was willing to undertake during a certain period of time that it is not willing to undertake now, and the types of premiums that they were willing to charge for those risks at the time that they undertook them.

Ms. WALTERS. Well, if that were true though, Mr. Rhodes, it would go the other direction. What I said was paid losses are increasing dramatically for certain types of insurance. Like I said, GL and medical malpractice which is the area where it is universally acknowledged as having the worst availability of affordability problems, paid losses grew 234 percent over that period of time.

If insurers were cutting away the bad business and keeping only, or hardly writing any, and just keeping the good stuff, the rate of growth——

Mr. RHODES. That is my point.

Ms. WALTERS. The rate of growth should be lower, not dramatically higher.

Mr. RHODES. That is the point that I am suggesting to you, that you could suggest the conclusion that they were in fact underwriting bad risks and not charging the type of premium that they should for the type of risk that was being written.

Ms. WALTERS. Well, except for the fact that paid losses in this area, we know that the tail means the length of time from a loss being incurred, that is, the incident taking place which is going to produce it, and the loss actually being paid, is 10, 12, 15 years.

So even if on January 1, 1985, insurers had sort of stripped away all of the bad business, the effects of that—oh, I see, you are saying it the other way around.

Mr. RHODES. Right.

Ms. WALTERS. If they had written just all bad business. Well, then, what did they get rid of in 1985 and 1986?

Mr. Rhodes. Well, in my experience, obviously in the experience of Mr. Hayes, and I suspect, several others sitting here, up until January I was not a congressman. I was a lawyer. And just in my personal experience in my practice, I can tell you a lot of people and a lot of things they got rid of because they suddenly decided that they did not want that risk anymore at any price.

Ms. Walters. But what I am suggesting is if you were saying that all they were insuring were the bad risks.

Mr. Rhodes. I am not saying all they were insuring. I am saying they certainly insured a lot of risks that either they would not have or that they charged premiums such that it was not appropriate to the risk being undertaken.

Mr. Angoff, I would suggest to you another category of inquiry that would be interesting in testing the experience of the insurance industry, vis-a-vis, the civil justice system. And that is you mentioned the widely reported, very high jury awards and that sort of thing. I think the one interesting thing that would shed some light, perhaps not a spotlight, but maybe a candle is worth a light, might be important, is to examine jury awards that were in excess of the policy limits, because certainly policies do not cover what they do not cover, and I know that jury awards frequently are well in excess of the policy limits. So the $1 million loss really was a policy limit loss which could have been substantially less than that $1 million loss.

You have indicated that there are categories of information that would be useful to us in analyzing this entire situation and certainly the categories you identified I agree with, and you keep saying that it is simple to get that information. It would be simple for the insurer to break the information out and to provide it.

I will agree with you that it probably would be relatively simple for them to break the information out. It is the simplicity of acquiring it that bothers me. You sort of waved the magic wand of us passing the law and that is all that needs to be done, but who is going to collect that information?

Suppose we decided that there should be Federal legislation to collect this data. Where are we going to have it sent to? Mr. LaFalce's office? Where is it going to go? Who is going to collect it and who is going to analyze it? And more importantly, what sanction can we impose upon an insurer that did not provide the information? The words, again of a lawyer, what is our jurisdiction in this situation?

Mr. Angoff. Today, you have no jurisdiction. Today, there is no Federal agency that has any jurisdiction over the insurance industry.

Now there have been suggestions made. I think there is a draft bill that would have insurance companies report certain data to the Small Business Administration. Some people have suggested the Federal Trade Commission. Some people have suggested the Commerce Department. But right now you have no jurisdiction.

I would like to emphasize that there is a difference between jurisdiction to regulate and jurisdiction to collect data. I know that our organization and all the other business groups and banking groups and a number of other organizations with widely different perspectives who would like to see the Federal Government collect data are opposed to the Federal Government regulating the business. But I think any number of agencies could collect data from the agency, but you have to pass a law obviously to give yourselves jurisdiction.

The second question goes to the simplicity of collecting the data.

Mr. RHODES. Wait a minute. What about the sanction for those who don't provide?

Mr. ANGOFF. Well, obviously, as long as you do not have jurisdiction to collect the data, you certainly do not have jurisdiction to impose sanctions on those who do not submit the data to an agency that——

Mr. RHODES. That does not have any regulatory jurisdiction, right.

Mr. ANGOFF [continuing]. Does not have regulatory authority. But you could pass laws, obviously, giving the authority to an agency to collect the data and giving the authority to that agency to impose sanctions if the insurance companies fail to submit the data.

Mr. RHODES. Which then makes it a regulatory law and not a data collecting law.

Mr. ANGOFF. Well, as long as the jurisdiction—well, the only thing that would be regulated—that is true. The failure of an insurance company to submit data then would be regulated by the Federal Government. But the Federal Government's function, as we see it, should be solely limited to collecting data.

The second question was how simple is it to actually get this data. The insurance industry does not now, as Mavis pointed out, routinely collect this type of data, and therefore, their perspective is because we do not routinely collect it, therefore in some way you do not need it.

It is true they do not routinely collect it. Obviously, legislators do need it, and it would be a simple matter, prospectively certainly, for the insurance industry, insurance companies to develop procedures that would allow companies to make notations to collect certain—when certain things happen.

I mean it would be simpler for verdicts as I pointed out in my written testimony, it would be simpler for verdicts than for settlements. But it would, certainly, be very simple, punitive damages is the easiest. It would, certainly, be very simple for insurance companies to report when there is punitive damage verdicts and then if and when and how much they pay in punitive damages, the same thing for noneconomic damages, and by the way, legislation like this has just been enacted in Missouri. So I think Missouri is the first State that does require insurance companies to disclose when they pay more than $300,000 in noneconomic damages, and when they pay more than $300,000 in punitive damages. It would be simpler to do it prospectively than retrospectively.

Mr. RHODES. Well, I would just observe to you that I do not think it is simple, that in my judgment the leap from the Federal Government requiring the collection of data to regulation is not a quantum leap at all, but barely a hop, step, and a jump. It is not the direction that I would, personally, wish us to go, and I think the Missouri example is one which I would encourage the other States to follow.

Certainly, I concur wholeheartedly that even for us to draw a no action conclusion in this situation, we need to have this information and the frustration is how to get it without having us take the first steps along the road toward Federal regulation of the industry, which as I said, I am not prepared to take at the present time.

Thank you, Mr. Chairman.

Mr. LANCASTER. Thank you.

This has been a terribly interesting meeting for me. As Mr. Rhodes, I, also, am recently elected to Congress having served in the legislature for 8 years where we struggled with the liability crisis. At the State level, I thought that our problems were because of the relative lack of power of the States to compel insurance companies to provide us the data that we needed to make decisions with regard to this crisis. I see that the all-powerful Federal Government has not been able to compel them to provide that data either. So, apparently, my frustration has not ended by having been elected to Congress, and I will continue to have to struggle with the recalcitrant insurance industry in providing the information needed to truly evaluate the liability crisis and what reforms might impact on that crisis.

And Ms. Walters, I wonder if you could tell us why it is so difficult for the insurance industry to comply with requests from the States and Federal Government to provide the specific data requested?

Ms. WALTERS. Again, I would have to say, Mr. Lancaster, I will support exactly what GAO said earlier. It all depends on what the request is. As I said in my formal testimony and as acknowledge by Mr. LaFalce, there is an enormous amount of data already out there routinely collected. And it has evolved because of the traditional needs of Government and of the industry.

One of the traditional needs of Government, and by the way, still an incredibly high priority which we should not lose sight of, is to monitor for solvency and solidity. In the last 3 years, we have had a record number of insurance companies become insolvent, go bankrupt. That, certainly, does not help anyone.

So, the annual statement and the financial reporting there has been directed to address that need so that insurance departments and regulators can monitor that.

Mr. LANCASTER. Ms. Walters, that need is to have data to determine whether or not reform should be enacted——

Ms. WALTERS. Right.

Mr. LANCASTER [continuing]. And which ones.

Ms. WALTERS. Exactly.

Mr. LANCASTER. If that data would in fact support reform, why has the insurance industry been so reluctant to give that data?

Ms. WALTERS. Well, I think it is a question again, even as Mr. Angoff said, of whether you are looking forward or whether you are looking backward. You cannot create data where it does not exist.

When people are asking new questions for which the routine data collection mechanism did not anticipate, then we cannot just say, whoops, let us run the machine and get that answer. But answers are in the process of being collected at this very moment.

Again, I talked about two studies that we are doing. The first one, the claim evaluation study was being conducted by this independent management consulting firm, who is trying to get a quick, short-term evaluation of some of the answers to exactly the question you just raised. That is, what are the relative merits, if any, of certain types of tort reforms that have, in fact, already been enacted. Will they have an impact. On what kind of claims are they likely to have an impact. And what is the relative order of magnitude. Are caps on damages likely to have a greater impact on claim costs than collateral source determinations.

That study will be completed and the results will be available within the next 4 weeks. So, we are doing two things. One, we are trying to answer the short-term need for a special study, and that study has been completed and the reports are now being written.

The longer term questions though that get to claim file penetration as was described. You know, some information is routinely mechanically available. Others, you can only get by having people actually penetrate the claim file, and every company keeps their claim files in a different fashion and have different information available.

That study is underway. We have already pilot tested the form. We learned a lot by doing a pilot test of the survey form. We are going to have another pilot test within a week, and then we are going to go forward and collect the information. And that is going to have a lot more data that has not, heretofore, been available, but it is going to make it available to all of us to form our own conclusions.

Mr. LANCASTER. But, Ms. Walters, you yourself, in your testimony just a few minutes ago, indicated the great difficulty in making those subjective judgments as to what prospective tort reform might do to claims. You are an admitted expert on this, but you are asking claims adjustors, or at least senior claims managers, to make those subjective judgments.

Would it not be better to simply provide the data with regard to these losses? If in fact joint and several is the problem, why don't you simply provide the statistics of the problem? How many of those cases did result in an insurance company having to pay a claim greater in proportion than their fault?

Ms. WALTERS. In fact, we are going to do both. The claim file data analysis will have both kinds of information. It is going to have the objective information available to all analysts who want to take a look at it. It is also, in addition, going to provide us with an evaluation of if this one situation changed, as it did in the law, they will be looking at claims that they are working on where they are most familiar with the details and the information in that claim, and they will be taking us, OK, if it is a closed claim, this is what it was closed for.

Then they are asking that claim supervisor if this law had been different in this specific way, what, in your judgment, would that claim have closed for. They are going to be asked to do the same thing on claims that are currently opened, giving the evaluation of what it is now——

Mr. LANCASTER. Ms. Walters, you are going back now, to the subjective. I am asking about the claims experience on specific problem areas such as joint and several, such as noneconomic loss. Are those not far more instructive in the whole reform debate than the subjective opinion of a claims adjuster that it might have been different if these reforms had been in place?

Ms. **Walters**. No; actually, there is no such animal as an objective determination of the kinds of things you talk about. Let me be specific.

Unless a case has been tried to verdict and unless the law that was applicable in that State permits the introduction of collateral source information and unless in that particular State the jury is always instructed to specify the dollar amounts in the verdict, unless every one of those things takes place, the amounts in the claim file for these various and sundry things that we speak of are totally subjective, because there is no objective determination in any other case.

Mr. **Lancaster**. But, is it not less subjective than a question about what the impact of a particular reform might have been on a claim?

Ms. **Walters**. No; I do not think so, because the people who are evaluating that claim situation are the experts. They are the people who are doing it every single day. They are the ones who establish the loss experience for individual insurers. It is their profession. It is their livelihood. They are in the best position to do that and to say this is—this is the value of the claim rather than someone outside that environment who does not deal with——

Mr. **Lancaster**. No; I am not saying that someone else should provide that. I am saying would it not be easier for that same claims manager to estimate the prior claim's experience with regard to collateral source, with regard to joint and several, than it is for him to make the far more subjective judgment of what the impact might have been of a particular reform.

Ms. **Walters**. I think that is what they are doing if I understand you correctly.

For example——

Mr. **Lancaster**. Well, I just——

Ms. **Walters**. What you are saying is exactly what they are going to do.

Mr. **Lancaster**. No; I know that is what they are going to do. What I am saying is is that not more objective, even though it does have some degree of subjectivity, than the far more subjective judgment of the impact of a reform upon a prospective claim?

Ms. **Walters**. I am not sure I understand your question, Mr. Lancaster. I am sorry.

Mr. **Lancaster**. That is all right.

Mr. **Kaufman**. If I could add a comment on that.

Mr. **Lancaster**. Sure.

Mr. **Kaufman**. Some of these issues are more subtle than it appears. If you changed joint and several, what you do is change the way a municipality, for example, needs to look at a claim. If they are minimally involved in a claim and there is no joint and several, they might choose to defend the claim and have a high likelihood of winning.

Mr. **Lancaster**. I agree. I think that kind of information is far more helpful in judging whether or not we need to change joint and several than what a claims manager thinks might have been the impact if that law had been in effect.

Mr. KAUFMAN. I think what happens in a—if you look at the actual settlement, the settlement is not labeled this is a payment we made because we do not have $10,000, $5,000 of which is joint and several, $5,000 of which is real. We simply have $10,000 based on all the facts in that case.

It would be helpful to know as—from an analytical standpoint, I am not part of ISO, I would like to see as much detail as they will provide about how they reach their conclusion. But one interesting piece of information would be the conclusion of someone familiar with that particular claim who could say, I knew everything about claim No. 6, and if I were in Missouri where they changed the law rather than in Kansas where we have this law, then my answer would have been different.

That is a different question from what are the hard facts in the file about how much went for this and that. If they have both, I think that will be useful information to people——

Mr. LANCASTER. Well, I think both will be useful. And I think it would be helpful for this committee and other committees of Congress and in the States to also have as much detail as possible.

I wonder, Ms. Walters, exactly what statistical detail will be available from your report, or is it going to be simply percentages and graphs and charts and——

Ms. WALTERS. Oh, no, sir; we, historically, where we have done studies before, publish all of the findings of this report. We also do an analysis, but we publish, if you will, the raw findings to allow others to do their analysis as well. That is the way we have always operated. That is the way we will continue to operate here.

I do not have with me the up-to-date claim form. It is extensive. I know it encompasses many, many, many, many, pages, 30 or 40 questions, some with subparts. In fact, we asked for advice and we have received some very good advice, both from GAO, from the Department of Commerce, from Federal interests, from State interests, from the NAIC. We gave them the form. We said let's talk about this. Do you have some suggestions how we can refine it and make it better? As I mentioned earlier, we have pilot-tested the form. We found we had to make a few changes, extend the questions, make the questions a little better in some instances. We are going to pilot test now the new form again.

We will be publishing all of the results and all of the findings as soon as it becomes available.

Mr. RHODES. How soon—I'm sorry.

Mr. LANCASTER. Go ahead, John.

Mr. RHODES. Will you yield for a question?

Mr. LANCASTER. Sure.

Mr. RHODES. When all this is said and done and your study is completed and your objective analysis is completed and your subjective conclusions are drawn, do you feel that you will be able to say it is our opinion that if the following tort reforms were undertaken, that they would or they would not have an impact upon insurance premiums?

Ms. WALTERS. I think this information will go a long way to telling us in whatever the States were, and I do not remember how many there were, 27 States. In this State where they really did have specific tort reforms, let us say in Florida, in the opinion of the claims person involved, this is what the effect is. We are not going to say whether it is good or bad. We want to just present the information. This is what the best estimate is as to what this effect is.

Mr. RHODES. They will tell you what their best estimate is as to the losses.

Ms. WALTERS. That is right.

Mr. RHODES. Someone else is going to have to draw a conclusion as to premiums.

Ms. WALTERS. That is right.

Mr. RHODES. Do you feel you will be able to do that as a result of this study?

Ms. WALTERS. We do not believe we are the appropriate ones to make that determination. Rather, we believe individual insurers have to evaluate the conclusion, or the information, the analysis that is presented, and make their own determinations based on their own book of business.

Remember, we talked about it a little bit earlier. I explained it. Depending on if you write a lot of high volume, high risk, high limit business, then your book of business is likely to be more affected by let us say limitations, if there are limitations on noneconomic.

On the other hand, if you are an insurer that, generally, writes Main Street businesses and you do not provide limits of routinely more than about $100,000, then caps are not going to have an impact on your book of business at all.

So, we think it is appropriate for each insurer evaluating their book of business and even by classes of business how they should adjust their premiums accordingly.

Mr. RHODES. But that confuses me a little bit. You are currently making insurance rate or insurance premium recommendations on studies that, basically, are very similar to this, except that they are not theoretical in nature. So, why would you not be able to tell from the Florida study with your subjective analyses of the impact of tort reform on losses, what the impact should be on premiums?

Ms. WALTERS. Because what we do today is develop an advisory average rate, which we think is an actuarially valid rate for the average risk in each defined class based on aggregate experience of all insurers.

We do not make determinations or advice as to what the marketplace price should be. In fact, quite to the contrary. We do everything that we can to advise the insurers who use our information that they must make their own independent determinations, even today, with respect to things like expenses, profit load, competitive——

Mr. RHODES. Look, I understand that, I understand that. But why can you not make the same kind of—if this were a perfect world in the insurance universe, this is what you should charge in light of these changes in the tort laws in Florida, and in light of our subjective analysis of the impact? Why are you not able then to make that perfect world analysis on a rate so that we can say, yes; this is going to do something to rates or, hey; it is not going to do a thing to rates in the perfect world?

Ms. WALTERS. I guess it's a question of could we do that or are we likely to do that. And I was trying to answer, are we likely to do that. And our answer is, no; we are not likely to, and that is being driven by the procompetitive direction that the ISO board of directors has instructed our staff to work in, which is not to try and make the marketplace decision, but let—force individual competitors to make those marketplace decisions.

We will do everything we can to present as much objective analytical information to them to assist them, but that in the long run, in certain areas, and this clearly being one, they must make their own determinations, because they are the ones whose surplus is at risk.

Mr. RHODES. Well, I understand that, but there are people such as the Florida legislature, the United States Congress, the Small Business Committee, who would like to take a look at your information and determine whether or not what is being advocated is going to have an effect. And clearly, you are not going to tell us that, so I wonder what value it is.

Ms. WALTERS. Oh, no, Mr. Rhodes, no; I did not mean to suggest that at all. No; we are going to share the results of this study. We are going to give to everyone what our analysis concludes in terms of likely effect on the claims environment, but taking that next step for likely effect on the claims environment to charging marketplace prices is a large step, and the insurance departments, legislative bodies will all have the same information we have, and we think it is up to them to challenge the individual insurers on the basis of, well, you justify your conclusion based on the ISO study, and the conclusion of Aetna may be different from Travelers, appropriately, and different from AIG and different from all the others.

Mr. RHODES. Thank you for yielding, Mr. Chairman.

Mr. LANCASTER. How will your study differ from the Aetna study in Florida?

Ms. WALTERS. I, frankly, do not know exactly what the Aetna study did. I think it was a very quick look at a couple of hundred claims.

Our study, as I indicated, has been much more rigorous in the study design. We have spent literally——

Mr. LANCASTER. But were they not asking basically the same kind of questions?

Ms. WALTERS. I am sorry, Mr. Lancaster. I never saw it. I do not know.

Mr. LANCASTER. Do you have some——

Mr. ANGOFF. I will be glad to provide Mavis a copy, and I would like to submit it for the record if I might. It asked questions on the five, what we call the big five tort reforms, and it went through an actuarial analysis in concluding why each of these would have no effect.

Mr. LANCASTER. All right, if in that study Aetna concluded that these reforms had no effect, why is it likely that that would not be the same result of your study?

Ms. WALTERS. Because we are going to do a lot more—we are asking a lot more questions and we are not going to just present conclusions. We are going to present all of the objective information as well.

Mr. LANCASTER. I wonder if the reason might be that Aetna's study was after the tort reforms were enacted and they were then trying to justify not reducing their premium, or to get Florida to remove the cap on premiums because of the enactment, as opposed to your study which will be for the insurance industry in an effort to provide data, or at least arguments to make those reforms. Could there not be that distinction?

Ms. WALTERS. No; I do not think so, Mr. Lancaster. In fact, I am glad you brought that up because there is—no one here has said it, but I think that there may be an underlying fear that, as others have said, well, there is a credibility question because ISO, which is an industry organization, is conducting this study and, therefore, are not your results going to be biased?

I would suggest to you that there is not even any unanimity within the insurance industry, and I think folks who have dealt with insurance companies will support me on this. That is, there are a lot of insurance companies who have been out in front saying you have got to have tort reform, you have got to have tort reform, and going to the mat on it.

There have been just as many other insurance companies who say I do not think this is any of our business. I do not think we should be out in front on this. I do not think tort reform is all that important.

You have got some insurers who would, at least intuitively, maintain that tort reform is going to make a big difference. You will have other insurers who will maintain tort reform will not make any difference at all. Everybody is in the pool on this study. So that there is no way that you can predetermine the conclusion because I do not think—and first of all, the claims people are the last ones who get involved in public policy debates, so they are not up there arguing one way or another. They are just trying to——

Mr. LANCASTER. But everybody on the street corner has an opinion on this public policy debate, do they not?

Ms. WALTERS. That is right, that is right. But that is why what we are looking for is as objective an analysis as you can get, recognizing we are dealing with a subjective subject, and we are just going to try to do the best we can. And we cannot say it is 100 percent certain, but we are trying to add information, valuable information to the public policy debate without our prejudging the conclusion or saying we think it should be this or that. We are not going to argue anything with it. We are just going to present it and let those whose job it is to make the arguments make whichever arguments they want.

Mr. LANCASTER. Ms. Kladiva, you indicated that with regard to medical malpractice, you had had a good bit of data available to you for your use. Do you have an opinion as to why those data were available whereas other liability data are not?

Ms. KLADIVA. Are you talking about data from claims files or are you talking about paid losses and that type of data?

Mr. LANCASTER. Yes; all of the data.

Ms. KLADIVA. Well, with regard to the case studies that we did in six States and talking with 27 different insurers and collecting very detailed statistical data from them, I would say that they were very cooperative in providing the data to us. They gave us what we asked for. And it took, in fact, some time and additional effort on their part in order to provide the data in the format that we had asked for it in.

Mr. LANCASTER. All right. Now you are not asking the question. You are explaining to me how helpful they were and how cooperative they were. My question is why is there so much more information available with regard to medical malpractice as opposed to general lines.

Ms. KLADIVA. Well, for one thing, medical malpractice is a separate identified line of insurance where under comprehensive general would be included the daycare centers, and other lines that are not reported as separate lines of insurance, and, therefore, all of the individual data on those sublines, if you will, are aggregated into general liability and reported in the aggregate form. So, that is probably the main reason—because medical malpractice is a separate line.

Mr. LANCASTER. Might it also be that perhaps the data with medical malpractice is, in fact, more supportive of the arguments for reform than that of some of the other areas of liability.

Ms. KLADIVA. I have not seen anything that would lead me to conclude that that was the reason. I think it is because it is a separate reported line of insurance.

Mr. LANCASTER. Mr. Delfico, please forgive my mispronunciation of your name. Do you think it might be necessary, even though Mr. Rhodes has expressed his own opposition to that sort of thing, but do you think it may be necessary to actually have Federal legislation for you to get the information you need from the insurance company to do the kind of study that is appropriate in this area?

Mr. DELFICO. That is one approach.

Mr. LANCASTER. I know it is one approach.

Do you think that it is going to be necessary.

Mr. DELFICO. It may be necessary, yes; it may be necessary. We have not had experience, I should mention, in the general liability lines yet and product liability. We have had a similar situation in private pensions for example. We did not have access to pension data for years. And it was necessary to pass legislation to get access to that kind of data.

Mr. LANCASTER. Are you preparing legislation now to request that assistance?

Mr. DELFICO. No; we are not. We are trying to work within the system as it exists today. And as Ms. Kladiva mentioned earlier, we have had some success in malpractice. We may or may not have the same success with general liability and product liability.

Mr. LANCASTER. But if this is a crisis that demands immediate action, should we not go ahead and take the necessary action to get you the data that you need to make that analysis for the Congress?

Mr. DELFICO. Yes; that is an approach that you can take. I have to warn you again that the data would take years to gather and analyze to come up with the answers to questions.

Mr. **Lancaster**. But if it is going to take years to gather it, do we not need to take the steps immediately, to gather what you need rather than use years of that valuable time to get the data so that you can start analyzing it?

Mr. **Delfico**. Yes, sir; I really do not know if we have a problem though, Mr. Lancaster, at this stage. Because as I mentioned, we have not been into the insurance companies. But if we do run into a problem, the answer to your question is sure, we would need that access.

Mr. **Kaufman**. Many of the companies from whom the GAO got data are clients of my firms. And one of the reasons that they respond is that they are asked a well-formed question with a specific study objective in mind, so they are in a position to respond and have confidence that the data is going to be used in a reasonable fashion.

Mr. **Lancaster**. Is it your opinion then that at least your clients if not the entire industry will be forthcoming with the data that GAO needs to complete this study?

Mr. **Kaufman**. My sense from my involvement with the insurance industry as a company person and a consultant is when asked a well-phrased question as part of a legitimate study that they tend to respond as completely as they can.

Mr. **Lancaster**. Who is the judge of whether it is well-phrased or not?

Mr. **Kaufman**. I said an impartial observer. I think that when you get an interest group perhaps like INCO saying that we need this data, there is reluctance. We need this data. And if it is not a well-phrased request, there is reluctance to provide it.

Mr. **Lancaster**. How about the State of North Carolina?

Mr. **Kaufman**. I am not sure.

Mr. **Lancaster**. Well, the point is that in my experience in the legislature, legislation was actually passed for the insurance company to produce data. The insurance commissioner is now before the North Carolina General Assembly, because it has been impossible for him to obtain from the insurance companies, even with legislation on the books, the data that he needs to advise the General Assembly on their tort reform actions.

So he has come back, I guess, to better phrase the questions. Because apparently with the questions that the General Assembly phrased last session, the insurance companies have chosen not to respond.

Mr. **Kaufman**. I do not know enough about North Carolina. But generally, a legislative type question is generally not one raised well enough for an insurance company to respond to.

Mr. **Lancaster**. Then I guess the Congress would not be able to phrase such a question either?

Mr. **Kaufman**. I think that is right. I think that it needs a detailed entity such as the GAO to get down to the nitty-gritty level where you do define a question that has a meaningful answer.

Mr. **Lancaster**. Then why cannot the GAO phrase that question and give it to us, so that we can legislatively mandate it?

Mr. **Kaufman**. I have not heard them say that they could not. They have done it for medical malpractice within the framework of a question of what is the impact of tort reform. They have got down and worked out questions, asked insurers for data, collected the data, and reached some conclusions. And they have not said that they could not do similar things in other lines of business.

Mr. LANCASTER. Mr. Rhodes, before we recess or until 12:00, do you have any further questions?

Mr. RHODES. No questions.

Mr. LANCASTER. Why do we not just take a brief recess. I am going to have to go myself, because I have a 12:00 meeting. But I assume that the Chairman will be back shortly, since he indicated that he would be back at 12:00 and it is 12:01 now.

[Recess.]

Chairman LAFALCE. The Small Business Committee will resume its session. I apologize to all of you for having to leave for the past hour or so. There was another commitment that came up after this hearing that I just had to fulfill. We will try to go no more than 45 minutes, and perhaps finish this hearing by 12:45 p.m. if possible.

I will try to make my questions shorter and more succinct, and I will ask each of you not to try to emulate me, but do better than me in that endeavor.

Let me say where I am coming from, and maybe it will make it easier for you to give me answers. With respect to the insurance industry, I do not want to put an undue burden on them to provide information to the world at large that is unnecessary, and duplicative, et cetera.

I do not need a mountain of information, and I do not think that a mountain of information as high as the Statue of Liberty or six times higher than the World Trade Center is necessary, et cetera. But I have a feeling that we have inadequate data in a concise form in a central location, whether that is the States, the NAIC files, the Federal Government, ISO's files, or whatever it may be, that is adequate and open enough for the public and public officials to make public policy judgments.

And perhaps, it is even unavailable to the insurance companies, so that they could make intelligent judgments regarding the establishment of rates and premiums.

With respect to the litigation explosion, there may or may not have been a litigation explosion in the past several years. I really have not seen the data that indicates that there has been this explosion in the aggregate.

There may have been an explosion in certain discrete categories, maybe in certain environmental areas, and that could be because of the Super Fund. And, maybe, in asbestos cases, because of a peculiar change in the law.

But I have not seen any of the data. The best study that I am aware of is done by the National Center for State Courts which says that there is not one shred of evidence that there has been a litigation explosion.

Therefore, I have difficulty with these proposed changes that would enact major reforms that have little or nothing to do with the precipitous increase that we have seen in premiums.

I have always felt that a uniform product liability law would be desirable. I think that it would help businesses, and that it would enhance their competitiveness, although I think that it is unrelated to the liability insurance crisis. I hate to see the insurance industry and trade associations take advantage of that to get something that they have long-wanted, which are draconian changes in tort laws, which is different from my definition of tort reform.

And so, in order to prevent draconian changes from being enacted, and in order to prevent the argument for draconian changes covering up a realistic examination of the practice of the insurance industry, I find myself in the uncomfortable position of having to constantly say that I do not see any evidence that there is a litigation explosion. That is not something that I would prefer to be doing. I prefer to be spending my time on other things.

I am wondering if we need some changes in McCarran-Ferguson. I am wondering if we need some changes in the rule prohibiting the Federal Trade Commission from even looking at the practices of the insurance industry. And I wonder if the Federal Government does not have some appropriate role with respect to data collection.

What that appropriate role would be is up for grabs. Perhaps we could collect the data ourselves. Perhaps we could just articulate standards that would have to be adhered to by the States when they collect data. Perhaps we should just federalize ISO, and we would have all of the data in the world that we need, and we would not have to reinvent the wheel. Perhaps there is some way that we could just have access to ISO's data.

With respect to McCarran-Ferguson, the role that ISO plays is crucial in determining what the future of McCarran-Ferguson would be. Because if there are any activities which might be affected by a repeal of McCarran-Ferguson, I would think that it might be the activities of ISO that would depend on whether it was repealed or modified.

So, with those thoughts in mind, so you have an idea of where I am coming from if you did not before, let me just ask a few questions.

Ms. Walters, is it not true that ISO has a dual role both as a statistical agent for the States and as a rate advisory agent for the insurance industry?

Ms. WALTERS. That is correct.

Chairman LAFALCE. Could you expand upon that? How do you act as a statistical agent for the States, and then how do you act as a rate advisory agent for the insurance industry?

Ms. WALTERS. In almost all States, insurers are required by law to report statistical information that will permit the regulator to evaluate whether rates in a State are in compliance with the statutory requirements.

To that end, that means that they require statistical information in greater detail by class, by coverage, and in greater detail than the financial statement. In almost all instances, the States do not want individual insurers to report that information directly to the States.

Because the States recognize, first of all, that it is not credible for individual insurers, that they need aggregate data, and it would be far more costly and wasteful of resources of the State for them to have to aggregate the data and get involved in that process. So they appoint statistical agents.

Your State is a case in point. New York does not even permit individual insurers to file directly. They require that insurers file through a licensed statistical agent. The statistical agent then develops the instruction book.

Chairman LaFalce. ISO is a statistical agent.

Ms. Walters. We are one of the statistical agents, that is correct.

Chairman LaFalce. Of the statistics that are provided to the States, the insurance statistics, what percentage of those statistics do you, that one agency, provide?

Ms. Walters. Again it depends on the line of insurance, because there are more than one statistical agent.

Chairman LaFalce. Right.

Ms. Walters. ISO is a stat agent and the NAII is.

Chairman LaFalce. But ISO dwarfs all of the others.

Ms. Walters. Oh, not true, not true.

Chairman LaFalce. No?

Ms. Walters. Particularly, when you are looking at the commercial lines of insurance. Excuse me, the personal lines of insurance. For homeowners and private passenger auto, another statistical agent has the majority of the data base.

Chairman LaFalce. Well, let us talk about the line "other liability."

Ms. Walters. For other liability of the insured data base, the data base that reflects operations of insurance companies, we have the majority of that. Again it varies by State.

Chairman LaFalce. You have the majority of that, but how much more of the majority might you have, is it 51 percent?

Ms. Walters. No, no; it is higher than that.

Chairman LaFalce. Is it 90 percent?

Ms. Walters. It is not as high as 90, but it is probably in the realm of maybe 75 to 85 or something like that. It will depend by State.

Chairman LaFalce. So 75 to 85 percent.

Ms. Walters. In commercial.

Chairman LaFalce. So you are big.

Ms. Walters. Sure.

Chairman LaFalce. OK. You are big when it comes to this line "other liability."

Ms. Walters. Yes.

Chairman LaFalce. All right, good.

If you are a statistical agent for the States, and I am becoming fonder and fonder of ISO, why should we not make ISO a statistical agent for the Federal Government?

Ms. Walters. That is a public policy decision, and we do not get involved in public policy discussions.

Chairman LaFalce. OK.

What does it mean to be a statistical agent? In other words, if you were a statistical agent for a State, it is tough for me to understand how you can be an agent for an insurance company, or owned by the insurance company, and an agent for the States, because it seems to me that there is an inherent conflict in those concepts.

Ms. Walters. No; in fact, the fact that we are also an advisory rate service organization——

Chairman LaFalce. We will get into that later.

Ms. **Walters**. OK. But you said that we were an agent of the companies. That is the only way which we are an agent of the companies, by being an advisory rate service organization.

Chairman **LaFalce**. I said, even more than being an agent of the companies, you are owned by the companies, you are the companies. And so, since you are the companies, since you are owned by the companies, the question regarding how you can be an agent of the State in dealing with the companies when you are a company, presents somewhat of a conundrum.

Ms. **Walters**. I suppose that it all depends on one's perspective. When you recognize that insurers have very little if no motivation to deceive in the basic data that they report because data are their life blood. When you are dealing with an insurance product, you are dealing with something that is totally prospective. And they need data, accurate, reliable and meaningful data in order to conduct their business.

Chairman **LaFalce**. Well, what does it mean to be a statistical agent for the State? Are you really an agent for the State? I mean are you somebody who provides information to the State as agent for the State?

Ms. **Walters**. I am referring to the statutes and the laws in the States, which they have a specific requirement. And within the laws, they will talk about statistical agents, and you have to get a license. You are licensed as a statistical agent. Your statistical plan is approved by the State government. And when you do that, you have the responsibility to provide data.

Chairman **LaFalce**. Since you are a statistical agent for States, and you accept the designation as statistical agent for them, do you, therefore, have to provide them any data that they request?

Ms. **Walters**. Pretty much.

Chairman **LaFalce**. You could not claim that this is proprietary information?

Ms. **Walters**. No.

Chairman **LaFalce**. OK. You do what, you provide them information or claim that it is proprietary?

Ms. **Walters**. We do provide them with information in accordance with the statute. And in most instances, the statutes require that statistics be recorded consistent with the classification plans in use by insurers.

So, for example, if a State were to ask for information recorded or reported in such a way that was totally inconsistent with the statistical plans, it would not exist. They would not have it to report.

Chairman **LaFalce**. What if we made ISO a statistical agent of the Federal Government also, and then permitted some Federal agency, maybe the Department of Commerce, to access your information as they deemed it necessary and desirable?

Ms. **Walters**. Well, as I mentioned, the prerequisite to this statistical agent function is the existence of State regulatory laws which require that rates shall not be excessive, inadequate, or unfairly discriminatory. So, pursuant to fulfilling that regulatory function, they need data to enable them to do that. Hence, statistical plans and statistical agents.

So, it is pursuant to State regulatory authorities, regulatory responsibility over rates, that gets to the stat agent function ultimately.

Chairman **LaFalce**. Now you give out rate advisory statements to the insurance companies.

Ms. **Walters**. To those who buy it, yes; insurers who want it.

Chairman **LaFalce**. Does anyone monitor the extent to which the companies who buy your rates actually adhere to your suggested rates?

Ms. **Walters**. Not to my knowledge.

Chairman **LaFalce**. Do you have any judgment as to whether companies in 1985 and 1986 were charging more than your recommended rates or less than your recommended rates?

Ms. **Walters**. I think that it has been my observation over the years that by looking at changes in the ISO advisory rate and written premiums, just looking at rates of change, and we can track that, it has been my observation——

Chairman **LaFalce**. Let me put it this way. The big jump was for the year 1984 to 1985.

Ms. **Walters**. And 1985 to 1986, two jumps.

Chairman **LaFalce**. 1985 to 1986. All right.

In "other liability," what percentage increase did you recommend in rates for other liability from 1984 to 1985, and then what percentage increase did you recommend from 1985 to 1986?

Ms. **Walters**. I do not have those numbers in front of me.

Chairman **LaFalce**. I mean was it 25 percent, 40 percent, 200 percent?

Ms. **Walters**. It would be OL&T, M&C, and product separately, the three major sublots. So probably in the magnitude, and maybe it was even less, but it might have been 10, 15, 20, 25, 30, somewhere like that. But that was a recommendation over our advisory 1984 rates.

Chairman **LaFalce**. Right. I understand what you are saying. But what you are saying is maybe 10 or 15 percent.

Ms. **Walters**. Or it could have been 20 or 30. I really have not looked at the numbers.

Chairman **LaFalce**. OK. We will keep the record open, and I will ask you.

Ms. **Walters**. Sure.

Chairman **LaFalce**. But it was not 200, 300, 400, or 500 percent?

Ms. **Walters**. That is right.

Chairman **LaFalce**. So, if the insurance industry had been following your recommended rates throughout, they may well have needed a 10- to 25-percent increase from 1984 to 1985 or from 1985 to 1986, correct?

Ms. **Walters**. Correct.

Chairman **LaFalce**. But not a 200, or 400, or 500, or 1,000 percent increase, correct?

Ms. **Walters**. Actually, written premiums increased something like 70 percent or something like that.

Chairman **LaFalce**. But that is in the aggregate, Mavis, that is in the aggregate.

Ms. **Walters**. That is what we are talking about, in the aggregate.

Chairman **LaFalce**. Well, I know that we are talking about in the aggregate.

Ms. **Walters**. It is 10 or 15 percent versus 70 percent.

Chairman **LaFalce**. Right.

Ms. **Walters**. That would be right.

Chairman **LaFalce**. The 10 to 15 percent opposed to 70 percent?

Ms. **Walters**. The 70 that the written premiums actually went up.

Chairman **LaFalce**. OK. In other words then, let us take your 15 percent figure and your 70 percent figure, and you are talking about insurance companies in the aggregate that are charging rates that are 400 or 500 percent more than what you recommended.

Ms. **Walters**. No.

Chairman **LaFalce**. The 70 as to 15.

Ms. **Walters**. No, no, no; it is all critical. That is why I said see what your starting point is.

Chairman **LaFalce**. No, no, no; that is a separate issue.

Ms. **Walters**. It is not.

Chairman **LaFalce**. It is a separate issue. You recommended, you now say that we can use 15 percent. And the aggregate was 15 percent, and the increase was 70 percent over the previous year.

Ms. **Walters**. No, no; the 15 percent increase that was recommended was over the ISO advisory rates in 1984.

Chairman **LaFalce**. And what was the 70 percent?

Ms. **Walters**. That was an increase over written premiums in 1984.

Chairman **LaFalce**. So we are comparing apples and oranges?

Ms. **Walters**. Absolutely.

Chairman **LaFalce**. OK, fine. We cannot do that. All right, fine.

Do you have any indication of what percentage increase they did have in the aggregate over and above your recommended rate in the year 1985 or in the year 1986?

Ms. **Walters**. No; in fact if anything, I suspect that industry-wide premiums are still below the ISO advisory rate level.

Chairman **LaFalce**. Based upon accumulation from the years in the last cycle, yes.

Ms. **Walters**. In other words, the ISO advisory rate levels are continuously going up.

Chairman **LaFalce**. I understand.

Ms. **Walters**. The written premium was doing this. The written premium is now up here, but it is still below.

Chairman **LaFalce**. I understand. And we still do not have any data regarding whether the cost of premiums have even kept pace with the cost of inflation from the time of the last insurance cycle. We do not have any information whether there has been an increase in the percentage of gross revenues attributable to insurance costs from one cycle to the other. Certainly from 1985 and 1984, yes.

Do you have that information?

Ms. **Walters**. I am not sure what you are driving at.

Chairman **LaFalce**. Well, let us say that at the time of the last crisis, circa 1978, that liability insurance would have been 1 percent of gross sales of a business.

Ms. WALTERS. No; I do not know that.

Chairman LAFALCE. Do we have any indication whether it is more than 1 percent of gross sales now. In other words, it may have increased by 500 percent in 1 year, and the insurance industry says "crisis," and everybody else says "crisis." But it could have been because of the underwriting practices in 1981, 1982, 1983, and 1984. And they still might be paying 1 percent of gross sales.

Ms. WALTERS. I see what you are saying. It might be. I have not looked at that. I do not know whether anyone has done any studies on buyers. What you are suggesting is insurance buyers, what are they paying in relationship to their own sales?

Chairman LAFALCE. Yes.

Ms. WALTERS. I do not know. I do not know if anyone has done studies on that.

Mr. ANGOFF. Mr. Chairman, a business group called the Conference Board just came out with a study in which they found that the percentage on gross sales paid by most large companies for insurance was far less than 1 percent.

Chairman LAFALCE. And what about relatively, relative to say 10 years ago?

Mr. ANGOFF. I do not think that they looked at 10 years ago.

Mr. KAUFMAN. There is a group called Risk Planning Group that puts out studies every 2 years on the cost of insurance and self-insurance that would have trends in it. I do not remember any particular numbers. My sense is that there is a pattern.

Chairman LAFALCE. This is so relevant, it seems to me. It is so relevant. Now ISO does have some major competitors.

Does ISO provide information to their members and subscribers regarding what other insurance companies are charging; for example, companies that are not members of ISO?

Ms. WALTERS. The one product which we do provide to anyone who wants to purchase it are premium comparisons which are available only for personal lines, personal auto and homeowners. It is a competitive tool. And we do it, and a lot of other people do it as well.

Chairman LAFALCE. Counsel is advising me that ISO acts as a statistical agent of the State. It can fine insurance companies for failure to provide information to them in a timely manner.

Ms. WALTERS. This is a part of our data quality program.

Chairman LAFALCE. Right, and that you actually have done this, for example, overall it was up to $1.3 million in fines during one year from insurance companies.

Ms. WALTERS. Could be.

Chairman LAFALCE. And ISO keeps that money or the States get that money?

Ms. WALTERS. No, no; it would become a part of the—mitigate some of the expenses in our statistical plan operation which would ultimately lower overall expenses to others.

In other words, if there are insurers who are delinquent in filing data, the data are incorrect, they ultimately get fined, then it costs that insurer, but everybody else should not have to pay more because that insurer has erred.

Chairman LAFALCE. I am going to ask counsel to pursue this line of argument.

Ms. **Walters**. OK.

Ms. **Wittneben**. We are just interested in the fact that ISO is doing this on behalf of States.

Ms. **Walters**. Right, we are a statistical agent; yes.

Ms. **Wittneben**. Right. And the States need this data in a timely fashion.

Ms. **Walters**. Well, we have a responsibility to file statistical reports with the States every year in accordance with the outline that is spelled out in the NAIC statistical handbook. But because we are also a rate service organization, we also need that data which forms the core base of our actuarial analysis to develop advisory materials. So we care about timeliness and quality, at least as much or they go hand in glove for the rate service function, as much as for the statistical agent function.

Ms. **Wittneben**. Right. But you are fining companies if they do not provide the data to you in a timely fashion so that you can give it to the States when it is required——

Ms. **Walters**. Right.

Ms. **Wittneben** [continuing]. To meet the State deadlines.

Ms. **Walters**. As a practical matter—no, no; as a practical matter, the deadlines are more deadlines imposed by our internal operation that relate to the rate service function more so than to the statistical agent function. That is, we have never had—as best I know, I should not say it has never happened, but as best I know, we are able to meet the agent function and that timeliness is not necessarily threatened in that regard as much as it is to fulfill the time table that we have set up in advance for reviewing 16 lines of insurance in 52 jurisdictions every year.

And if, somehow, the data does not come in to allow us to keep to that timetable, it throws off all our other rate service obligations.

Ms. **Wittneben**. Right. So my question would be are you fining the companies then to ensure that ISO can file the data, or is ISO fining the——

Ms. **Walters**. So we can fulfill our functions, all of our functions, right.

Ms. **Wittneben**. Right. And then that money goes back into ISO.

Ms. **Walters**. Right, it reduces the expenses, because we are not a profit-making organization. We have certain expenses of operations.

Ms. **Wittneben**. But on the other hand, you are still collecting fees from these companies to participate in ISO.

Ms. **Walters**. Right.

Ms. **Wittneben**. So you are fining your own members then basically.

Ms. **Walters**. That is right. In fact, the way this whole program was approved by the ISO board of directors, and it had to be approved obviously by the board of directors, was because they have a commitment to high-data quality, completeness of data, accuracy of data. They are very concerned about that. They recognize that they need the data and that they have a responsibility to have accurate, complete data sent to the State regulatory authorities. Their commitment was, indeed one could say colloquially, they put their money where their mouth is by accepting a program that had fines, among other things, as sanctions against insurers who did not live up to the——

Ms. WITTNEBEN. Do the States have any sanctions if you do not file the data in a timely fashion?

Ms. WALTERS. I honestly do not know the answer to that question. They must, but I honestly do not know. I could find that out for you, I think.

Ms. WITTNEBEN. All right.

Chairman LAFALCE. Mr. Delfico, how helpful would it be to GAO if you had access to the aggregate data in possession of ISO right now? Then you would be able to have this type of information in the future, so we would not violate any proprietary laws because you would not be able to tell which individual insurance company did this, that, or something else, but you would just have aggregate data. Can you see that being useful for the public at large?

Mr. DELFICO. I could see it useful for our work in trying to link tort reform to premiums if it were broken down by line and disaggregated as much as possible. Aggregate data gives us problems at times when we do our analyses. So we would prefer to——

Chairman LAFALCE. I mean aggregate data by line. When I say aggregate data, I mean aggregate data under the individual insurance companies.

Mr. DELFICO. OK, yes; no problem there. We would not need that.

Ms. WALTERS. May I speak up though?

Chairman LAFALCE. Yes.

Ms. WALTERS. I think the record will show that ISO has been extremely cooperative with any and all investigators who have come in from GAO and asked for data. We have given them anything we had access to that was readily available, we have provided them. So I am simply suggesting it is not required that you have legislation to do this, but we have been doing this routinely.

Chairman LAFALCE. Has there been data that GAO has needed and has been unable to get, or have you been able to get all information that ISO has that you deemed relevant?

Mr. DELFICO. In our experience, we have been helped quite a bit by ISO. They have given us the information. Is that true, Susan?

Ms. KLADIVA. Same in medical malpractice.

Chairman LAFALCE. And Ms. Ekstrand?

Ms. EKSTRAND. That has been the case. In my work, we have not asked for specific data sets at this point. We certainly have not had any indication that they would be denied.

Mr. KAUFMAN. There are important limitations on what you can get out of ISO. Some of it relates to the companies that participate. Those companies that sell large limit policies, what are often called umbrella liability policies, are often not—do not report that data to ISO, and some of what people are experiencing as the liability crisis relates to their ability to buy $2 million, $5 million, $10 million liability coverage. Information on that experience is typically not in the ISO data base because those companies that do it do not report it. Companies that do it are not ISO reporting companies, or the companies who do it do not report that type of experience to ISO. That is one limitation.

There is also certain sublines of business like errors and omissions type coverage, real estate agents, accountants.

Ms. WALTERS. Architects and engineers.

Mr. KAUFMAN. Architects and engineers, directors and officers coverage which, to the extent that it is reported to ISO, is all lumped together in a way that would not let an analyst pull it apart and do anything useful.

And in addition, some of the writers who do that kind of business do not report experience to ISO.

Ms. WALTERS. There is also, unfortunately for some—as Allan points out—some of the troubled lines have traditionally been insured by excess and surplus lines writers, the nonadmitted market, and they are not required to report data to anybody. So no one has access to that either.

Chairman LAFALCE. Well, let us pursue that now. You are saying some of the most troubled lines——

Ms. WALTERS. Some classes like liquor license.

Chairman LAFALCE [continuing]. Are insured by surplus lines, and they are not required to provide data to anyone.

Ms. WALTERS. That is correct.

Chairman LAFALCE. Now obviously that data does not exist then.

Ms. WALTERS. Unless some of the trade associations can aggregate it on a voluntary basis. But that is right, it is not reported to regulators in any fashion.

Chairman LAFALCE. Well, when trade associations come before me their data is usually worthless. They will conduct a survey and they will present that as data.

In what other type of lines would we have this really woeful lack of data?

Ms. WALTERS. I think Allan can answer that.

Mr. KAUFMAN. I think the ones I have listed, umbrella liability coverages, directors and officers liability, errors and omissions type coverages which covers actuaries, accountants, lawyers, and that list goes on. That type of coverage I think are the most—the omissions that are most evident.

Chairman LAFALCE. OK. Well, has anybody within the insurance industry been saying that we have got a problem here? That we in the insurance industry do not have enough data, or any data, or any meaningful data on these type of lines? Has anybody been calling out for some remedy for this, either within in the industry itself or outside?

Mr. Angoff?

Mr. ANGOFF. Yes; they have been. There are a number of Wall Street analysts, I do not know whether you consider them within the industry, who have called for it. There are a number of independent agents, the magazine has called for it, for example, heads of brokerage houses have called for it. I think industry people when they talk among themselves, as anybody would, are much franker than they are when they speak publicly.

So, I think, it is no secret within the industry—I know it is no secret within the industry that they have not done a good job on collecting data. And as I think you pointed out in the beginning, at least this is the first time that at least the ISO is talking about paid losses.

Now it may not be for sufficiently detailed categories, but for the longest time they would only talk about incurred losses as if paid losses was something that was totally irrelevant.

Chairman **LaFalce**. I do not know that it is the first time. It is the first time that I am aware of, in any event, that they have talked about "paid losses."

Yes.

Mr. **Angoff**. I am sorry, Mr. Chairman.

There is one document that I understand exists which Ms. Walters says does not exist, and I wonder if we could get some clarification on that. My understanding may be incorrect, but my understanding is that there exists within ISO a document which goes directly to one of your first questions, which was—and the document does this. It says how much the industry actually charged in premium, I think, by line and by State, and then how much the industry would have charged had everyone adhered to the ISO advisory rate. And my understanding is that there is such a document. Ms. Walters said that does not exist. She may be right, but that——

Ms. **Walters**. No, no; I think—some time last year——

Chairman **LaFalce**. If there is not such a document, after you answer Mr. Angoff's question, should there be?

Ms. **Walters**. That is an easy answer. I think no. But anyway some time last year——

Chairman **LaFalce**. That is an easy answer too, I think yes.

Ms. **Walters** [continuing]. In California, we were asked when testifying before a legislative committee in California could we estimate what would have been the results in California if insurers had charged the ISO rate. And after explaining why it would be very difficult if not impossible to do something like that, we were able—we did put together a very rough estimate of what the experience would be, I think for OLNT for 2 years in California. That was it.

So, that sounds like what you were talking about, what would the experience have been if companies charged the ISO rate.

We do receive—when insurers file their statistical data with us, they do tell us that——

Chairman **LaFalce**. Ms. Walters, let me interrupt you.

Counsel advises me when she met with ISO people in New York City, she was advised that you were doing studies on the deviation between the ISO rate and the rate charged by insurers during the last cycle. These are the notes she took during the course of the meeting.

Ms. **Walters**. I am unaware of that.

Chairman **LaFalce**. OK.

Ms. **Walters**. Now what I thought you were going to refer to, I do not remember that, doing rates—let me say what I started to say what we do have, and it is no where near as descriptive as Mr. Angoff alluded to.

When insurers file their statistics with us, they do tell us what those statistics represent by our line of insurance, that is, OL&T, M&C, or products, et cetera. They tell us how much they departed from the ISO advisory rate through their deviations. That is, a lot of companies, if they do not charge the ISO rate, will have to file deviations, and they will let us know what that rate departure factor was.

And they do that, among other reasons, we need to know when we are checking our data quality if written premium comes in at a certain level but we say, gee, our advisory rate levels were here; is this written premium correct. It has changed from 1982, to 1983, to 1984. Does it make sense, because ISO advisory rates did this. So they have to let us know whether they were departing or not. This is on the data that they have sent us. So, they do give us a rate departure factor.

Some people look at that kind of a figure and say, gee, that is the difference between ISO rates and what companies were charging, and it really is not. It really is not.

Chairman LaFalce. What is this rate departure factor if it is not, what is it?

Ms. Walters. First of all, it is old. It is retrospective; it is not prospective.

Chairman LaFalce. Sure.

Ms. Walters. So companies do not tell us what rate they are charging.

Chairman LaFalce. Fine, OK.

Ms. Walters. And it is a broad——

Chairman LaFalce. How old is it?

Ms. Walters. Oh, right now——

Chairman LaFalce. One year.

Ms. Walters [continuing]. We are developing policy year 1985 data.

Chairman LaFalce. All right.

Ms. Walters. So it would be policies written in 1985.

Chairman LaFalce. All right.

Ms. Walters. And they tell us—as I say, when they file their statistical data, they do give us an indication of what the rate departure factor was. It is not by class, it is not—I do not even know if it is by State. I have seen a country-wide exhibit.

Chairman LaFalce. All right, forget about by State. It is just country-wide. You say it is not by class. What is it by? Is it by line?

Ms. Walters. Broad ISO line of business, OL&T.

Chairman LaFalce. Thirty-two different lines?

Ms. Walters. No; what we call our subline.

Chairman LaFalce. How many sublines?

Ms. Walters. We have probably, depending on how you count, 16 or 18. But for general liability, for general liability, which is the other liability annual statement line of business, we have three separate lines: OL&T, M&C, and products.

Chairman LaFalce. OK. Well, would each insurance company give you a rate departure statement for those three categories within other liability?

Ms. Walters. Yes.

Chairman LaFalce. OK.

Can we have that?

Ms. Walters. Perhaps I can ask, perhaps.

Chairman LaFalce. Have you given it to anyone?

Ms. Walters. I do not know. I honestly do not know.

Chairman LaFalce. Well, take it as an official request that we would like that.

You are doing it right now for the year 1985. When do you expect it to be completed, the compilation of this?

Ms. Walters. They are just beginning to put the compilation of the 1985 experience together. So, certainly, by the summer it is usually completed, and different lines of work on different basis. For the GL lines, we are starting to do that now. I could not say specifically, but I could find that out.

Chairman LaFalce. Is this published in any place?

Ms. Walters. I know it is provided to insurers.

Chairman LaFalce. Is it provided to superintendents of insurance in different States?

Ms. Walters. I do not know.

Chairman LaFalce. Would not a commissioner of insurance want to know what, by far, the best rating making organization in the country and the largest rate making organization, ISO, recommends for certain rates, and whether a company's suggested rates were in compliance with it?

Ms. Walters. Oh, they know that directly, because the insurers have to tell. If it is rate filing state and we have filed a rate on behalf of an insurer, they tell the insurance department in advance or whenever they have to, but they tell the insurance department we are going to depart from the ISO rate by whatever amount it is. That is a filing between the insurance company and the insurance departments, so the insurance department knows that.

What we are talking about here is old. It is not saying what insurance companies are doing today. It is what they did 2½ years ago. It is not what rates are companies charging today. But the companies tell the insurance departments what rates they are charging today. So that is already being done.

Chairman LaFalce. All right, so we are talking about two separate bodies of information.

Ms. Walters. Absolutely.

Chairman LaFalce. All right, regarding these two separate bodies of information, is there any public document like A.M. Best's Report which deals with the old info? I suspect not, because that does not exist yet.

Ms. Walters. No.

Chairman LaFalce. OK.

Ms. Walters. That is right, it does not exist.

Chairman LaFalce. Is there any public document such as a Best Report that some composite records on the basis of the applications made to those rate-filing States?

Ms. Walters. Well, I think when you get right down to it, there are a lot of insurance departments that put out consumer information guides.

Chairman LaFalce. Do these consumer information guides compare the rates with the recommended rates?

Ms. Walters. No; they just show the various rates being charged by various insurance companies. I mean I think consumers care more about how much do I have to pay for this than they do how does this relate to this organization I have never heard of, ISO.

Chairman **LaFalce**. Yes; I can understand that. But public policy officials must be concerned with both.

Ms. **Walters**. Well, as I said, they get—the insurance departments would know that. To the extent that they are in a prior approval or a file in use State, the companies tell the insurance departments what rates they are using. And if they are a company that otherwise should be using the ISO rate, they will tell the insurance department I am not going to use the ISO rate. I am going to use thus and so.

Chairman **LaFalce**. Is it required to say——

Ms. **Walters**. But they do not tell us.

Chairman **LaFalce** [continuing]. Only what rate you want, or also, is it required of them in States that they tell not only the rate they want, but the extent to which they are deviating from a recommended rate from ISO?

Ms. **Walters**. Well, that is what I am saying. When the insurance company is going to charge rates in a given State if this is a State that requires advance notice or file and use, the company—if they are totally independent from ISO, they have no reference to ISO. They just tell the insurance department what rates they are going to use.

Chairman **LaFalce**. All right.

Ms. **Walters**. Or they file for approval of the rate filing and go through that whole business.

If they are an insurer for whom ISO has filed rates on their behalf, that is one of the services they purchase from us and we filed on their behalf, then if they aren't going to use that rate, they have to file a deviation and tell the commissioner I am not going to use that rate. I am going to use minus 10, or minus 20, or plus 5, or what have you.

Chairman **LaFalce**. Well, what percentage of insurance companies ask you to file the rates on their behalf as opposed to filing the rates themselves?

Ms. **Walters**. Again, it varies by State by line. It is higher in commercial than it is in personal.

Chairman **LaFalce**. Well, let us take "other liability."

Ms. **Walters**. Right, OL&T, M&C, and products.

Chairman **LaFalce**. Right.

Ms. **Walters**. Probably the majority of insurers use our rate as some kind of a starting point. It may only——

Chairman **LaFalce**. That is not my question. My question is how many of them have you file the rates as opposed to filing it themself.

Ms. **Walters**. That is what I mean.

Chairman **LaFalce**. Oh, there is a difference between using your rate and having you file.

Ms. **Walters**. File on their behalf.

Chairman **LaFalce**. Now you have just said that when we file it on their behalf, then we have to point out the difference. I am wondering if they file it on their behalf, they do not have to point out the difference.

Ms. **Walters**. That is right, that is right.

Chairman **LaFalce**. Oh, then they do not——

Ms. **Walters**. If they file their own rates——

Chairman **LaFalce**. If they file their own rates, they do not have to point out any difference or deviation.

Ms. **Walters**. Oh, no; oh, no.

Chairman **LaFalce**. In what percentage of the case would the companies be filing their own rates, for example, in "other liability?"

Ms. **Walters**. If they are a company that has nothing to do with ISO.

Chairman **LaFalce**. No; if they are——

Ms. **Walters**. If they are an ISO company.

Chairman **LaFalce**. If they are. Obviously if they are a company that has nothing to do with ISO——

Ms. **Walters**. Got you.

Chairman **LaFalce**. Overwhelmingly almost all of them.

Ms. **Walters**. The majority of companies have probably authorized us to file on their behalf.

Chairman **LaFalce**. At some point in time. But I am not talking about authorizing you. I am talking about what percentage of the time do you actually file on their behalf, or what percentage of the time do they file on their own behalf, roughly? I do not mean exactly. I mean, do they file on their own behalf for "other liability" 90 percent of the time, or 10 percent of the time?

Ms. **Walters**. How would you classify by your question deviations? Would you say we are filing on their behalf or they are filing?

Chairman **LaFalce**. The question I was asking is who is filing for these rates.

Ms. **Walters**. I would say 90 percent of the time we are filing on their behalf. However, then they depart from that by taking other steps like deviations.

Chairman **LaFalce**. You cannot file then a deviation because——

Ms. **Walters**. We do not file a deviation. They must take independent action. We filed and have gotten, finally, let us say after, whatever, 6 months, we have gotten approval of a 20-percent OL&T rate increase in South Dakota. An insurer may look at that, therefore, and there is always a lead time so there would be an effective date, let us say, of July 1. The insurer may look at that. Now we have been authorized to file on their behalf, so they are authorized to use those rates.

They may then say, I do not want a 20-percent rate increase in Arizona or South Dakota effective July 1. I only need a 10-percent rate increase. I am going to file a 10-percent deviation off the ISO. Now that is oversimplified, but that is the way the process works.

Insurers, after we have taken action, insurers will look at what their needs are and make a determination as to what they should do.

Mr. **Kaufman**. After you look at those percentages, superimposed on that is the issue of excess and surplus writers who are not part of Mavis' discussion, who for many of these categories of business make—business where there are problems now or crisis back in 1984-85 were the ones who used to be writing the business. Municipalities that I did not mention before, there were several programs done by excess and surplus writers insuring municipalities as programs went out of existence.

Chairman LaFalce. And they provide data to no one.

Mr. Kaufman. They provide data—I am not totally sure it is no one, but they do not provide data in the way that Mavis is discussing. They do not provide it to a stat. agent.

Chairman LaFalce. OK. And actually, municipal liability insurance was one of the first discreet crisis which gave rise to the aura of a general crisis, correct?

Mr. Kaufman. Yes.

Chairman LaFalce. Yes; I think people saw the municipal liability crisis and then they jumped to the overall general crisis, whether it was justified or not. That is one of the problems that I had, too.

Mr. Angoff said there are five basic classifications of data that we need. Tick them off again very quickly, Mr. Angoff.

Mr. Angoff. Money taken in and paid out for the classes of other liability, daycare products, municipal, and so forth. No. 2, the difference between verdict amounts and actual pay out amounts. No. 3, data on the effect of various legal doctrines on insurance company pay outs. No. 4, data on the efficiency of the legal system. And No. 5, data on the accuracy of insurance company reserves.

Chairman LaFalce. All right. Now does anybody have any objection to that type of data being collected some place by somebody?

Ms. Walters. Some of it is being collected right now.

Chairman LaFalce. Some of it is being collected, but some of it is not being collected. So does anybody have any objection to that type of data being collected?

Mr. Kaufman. Not an objection, but you need a purpose, information on verdicts versus payment is not useful in setting price—not particularly useful in setting price levels.

Chairman LaFalce. No; but it might be useful in deciding whether to change a law with respect to——

Mr. Kaufman. When I do work in evaluating the potential price impacts of law changes, I work with payment information, not verdict information, literally knowing that verdicts in—a $1,000 verdict turns into $600.

Chairman LaFalce. You need to know total payments. I should not say total payment. I mean all payments, and then verdicts would be a subclass of that.

Mr. Kaufman. But see, Jay is distinguishing between what a jury says and what is finally paid on a verdict.

Mr. Angoff. I do not think there is any disagreement. He is an actuary and that is true, he uses pay out. But the public and legislatures sometimes use verdict, and that is why we need to get information on both.

Chairman LaFalce. You see, when the Department of Justice advocated their Federal changes in tort law for all classes of torts in the United States of America, they used jury verdicts as their example. And, of course, they never even consulted with Jury Verdict Research, and Jury Verdict Research testified at one of my previous hearings that their data had been grossly abused and misinterpreted.

But the Reagan administration itself used jury verdicts, perhaps inappropriately. But since jury verdicts are used, it might be necessary to have additional information regarding that, but this information would be inadequate in and of itself. Certainly, all payouts are much more necessary and desirable. But some of the information is needed not only if you are to make intelligent judgments, but also if you are to counter other people's arguments.

Mr. KAUFMAN. It goes to the purpose you want the data. That verdicts versus payments is probably——

Chairman LAFALCE. Well, there are multiple purposes.

Mr. KAUFMAN [continuing]. Least important.

Chairman LAFALCE. I think you are right. I think you are right except when you are dealing with somebody that is using a very fallacious argument and you have to be able to deal with that.

Well, look, ladies and gentlemen, I want to thank you for giving me so much of your time from 9:00 until 1:00, and I appreciate that it has been an imposition upon you. I look forward to further conversations with you, either publicly, or privately, or both.

Thank you.

[Whereupon, at 1:03 p.m., the committee adjourned, subject to the call of the Chair.]

PROPOSED SOLUTIONS TO THE LIABILITY INSURANCE CRISIS

WEDNESDAY, APRIL 29, 1987

House of Representatives,
Committee on Small Business,
Washington, DC.

The committee met, pursuant to notice, at 9 a.m., in room 2359-A, Rayburn House Office Building, Hon. John J. LaFalce (chairman of the committee) presiding.

Present: Chairman LaFalce; Representatives Mazzoli, Bilbray, Flake, Lancaster, Martinez, McDade, Rhodes, and Hefley.

Chairman LaFalce. The Small Business Committee will come to order.

On March 25, 1986, when I addressed the House of Representatives on the nature and impact of the current liability insurance crisis, I stated that I was experiencing a sense of deja vu. This was due to the fact that this crisis appeared similar in nature to the product liability insurance crisis of 1977 and 1978, although the current crisis may well be deeper and more severe because it involves more lines of liability insurance and affects more individuals and businesses. Also, the insurance industry is presenting the same argument regarding the cause of the crisis, an alleged increase in tort litigation, both frequency and severity, even though the industry once again has failed to substantiate its argument.

In 1977 when I chaired hearings on the causes of the product liability insurance crisis, the insurance industry stated that the increase in product liability rates was due to a dramatic increase in the filing of claims to over 1 million per year. When I requested the industry to provide empirical evidence to substantiate its claim, it failed to present this information.

Subsequently, a closed claims study carried out by the Insurance Services Office found that the range of product liability claims per year was from 60,000 to 140,000, not 1 million claims per year as stated by the industry, as stated by the industry repeatedly before Congress, as stated by the industry repeatedly in national advertisements, as stated by the industry repeatedly to every single insurance underwriter in the United States of America. Thus, the insurance industry's perception of the number of product liability claims had been exaggerated by a factor of 700 to 800 percent, which showed that the industry was basing its rate increases on very subjective and erroneous judgments, not on actual facts.

Unfortunately, the disclaimers made by ISO to a subcommittee of the Small Business Committee, that I chaired at that time, were not made to the rest of the world. And so the rest of the world went on believing that there were approximately 1 million claims being filed per year. And I could give you the exact same story with respect to the severity of claims. There were just unbelievably gross exaggerations.

So, when I heard the insurance industry present the same argument regarding an increase in tort litigation claims in 1985 and 1986, I once again requested the industry for empirical evidence to support its claim. And as I found in my hearings last year, and as we saw during our hearing on the availability of insurance data yesterday, the industry does not seem to have the data to support its case that the major cause of the crisis is an increase in tort litigation.

Instead, I found during my investigations into the causes of the insurance crises, that a multitude of factors have contributed to these problems, not the least of which is the financial and underwriting practices of the insurance industry itself. Insurance analysts have also argued that other factors need to be taken into consideration such as the cyclical nature of the insurance market, the role of reinsurance, various macroeconomic factors including interest rates, inflation, and taxation of the industry, the overall U.S. business cycle, exchange rates, the U.S. stock market, and so forth.

All of these factors indicate that there is no single solution to the present crisis. Hence, what is needed is a comprehensive, multifaceted approach that recognizes the complexity of the problem.

Now, I have been advocating such an approach to this problem since the 95th Congress. As long ago as 1978, I introduced legislation that would either repeal or amend the McCarran-Ferguson Act in different ways.

I also introduced legislation that would grant rule-making authority to the Federal Trade Commission to determine the legality of certain essential collective activities carried out by the insurance industry under the antitrust laws.

And I also have introduced legislation establishing a Federal Insurance Commission to help regulate the industry, and have also introduced a bill to provide uniform standards for Federal product liability tort laws.

This year I have refrained from introducing any of my insurance bills, at least thus far, so that we could examine the insurance crisis in the industry in greater depth; and also because it seems that there is now a disposition on the part of others to deal with the so-called crisis in a multifaceted, more complex manner. And I want to be open to their suggestions.

For example, it is my understanding that the FTC now favors either repeal or modification of McCarran-Ferguson or both, and that the Justice Department, if they do not favor it, believes that the burden of proof and persuasion rests with the insurance industry in order to maintain it. We will wait for the Justice Department to speak on that issue.

So, today's hearing is designed to examine the appropriateness of various solutions—perhaps solutions is too strong of a word—various approaches that we might take to help ameliorate problems in the insurance industry. And these could include: Repeal or modification of the McCarran-Ferguson Act, repeal of the law that prohibits the Federal Trade Commission from even studying the practices of the insurance industry, improved State regulation of the industry, collection of insurance data at the Federal level, Federal standards for data collection at the State level, an appropriate role for the Federal Government with respect to the insurance industry, Federal tort reform, and other appropriate legislative or regulatory actions.

We are indeed fortunate to have two distinguished witnesses who can speak with authority on, at least, some of these issues. And I will not ask them to speak on areas where they do not feel they have competent expertise or authority. The Honorable Daniel Oliver, Chairman of the Federal Trade Commission, and the Honorable Charles F. Rule, Assistant Attorney General of the Antitrust Division, Department of Justice.

Do any members of the panel have any statements they would like to make before we begin?

[No response.]

Chairman LaFalce. Also, before we call upon our witnesses, Mr. Andrew Tobias has given every member of the committee a book entitled "The Invisible Bankers, Everything the Insurance Industry Never Wanted You to Know."

Our first witness will be Mr. Oliver. And both Mr. Oliver and Mr. Rule, we will put the entire text of your statements in the record, and you may feel free to either read it or summarize it as you will.

TESTIMONY OF HON. DANIEL OLIVER, CHAIRMAN, FEDERAL TRADE COMMISSION

Mr. Oliver. Thank you, Mr. Chairman. I will summarize by reading a shorter version of the full text which can be put in the record.

Mr. Chairman and members of the committee, thank you for this opportunity to comment on the insurance industry and related topics. I note at the outset that I speak only for myself and not necessarily for the Commission or any of my fellow commissioners.

Mr. Chairman, neither I nor the Commission staff have as much knowledge about the insurance industry as we would like. As you know, the 1980 FTC Improvements Act bars the Commission from studying the business of insurance without express authorization from the House or Senate Commerce Committees. Fortunately, that restriction does not affect our enforcement authority. Under the McCarran-Ferguson Act we can, for example, still prosecute conduct in the insurance industry that involves boycotts, intimidation, or coercion. We have had some investigations in the industry and thus have some familiarity with current activities in the insurance market.

My letter of invitation to this hearing listed seven topics. The first was the repeal of the McCarran-Ferguson Act. I believe the repeal is long overdue. Exposing the insurance industry to the brisk winds of competition unimpeded by any Federal restraints other than antitrust laws can only serve to benefit consumers and promote the common welfare. The broad antitrust immunity enjoyed by the insurance industry under the McCarran Act is both undesirable and unnecessary.

I start from the premise that, in the words of the Supreme Court, "The unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress." We rely on the free market to insure that sellers will offer products and services with the best mix of price, quality, and other characteristics that consumers demand.

Exemptions from the antitrust laws are not favored, and the Supreme Court interprets them narrowly for that reason. Even as narrowly interpreted, however, the McCarran-Ferguson Act protects from normal antitrust scrutiny many activities that may injure consumers. It protects price-fixing, division of customers and territories, and imposition of uniform policy terms.

The McCarran-Ferguson Act purports to ameliorate its adverse effects by conditioning immunity on the existence of State regulation. Unfortunately, the courts have interpreted the acts regulated by a State law requirement very broadly, so that even a cameo appearance by the State will cloak private action with immunity.

Mr. Chairman, I believe it is not cynical to suspect that at least some insurers have taken advantage of the McCarran-Ferguson immunity to harm consumers. My prepared statement lists some examples of the anticonsumer conduct that the McCarran-Ferguson Act shields from antitrust scrutiny.

The arguments against repeal are unpersuasive. Insurers claim their industry is so different from others that it deserves a special dispensation from the Nation's competition laws. Of course, virtually every industry has problems that can be and are cited to support special protection from the rigors of competition.

Forty years ago, the insurance industry managed to convince Congress that the McCarran-Ferguson Act was essential both to preserve the States' autonomy to tax and regulate insurance and to permit beneficial cooperation among insurers. The tragic irony for consumers is that McCarran-Ferguson simply is not necessary to accomplish any of those goals. States may regulate insurers with or without McCarran-Ferguson.

Moreover, the State action doctrine lives. Thus, repeal of McCarran-Ferguson would not change the States' role as the primary regulators of insurance. Contrary to the insurers' unsupported allegations, repeal of McCarran-Ferguson will neither lead to comprehensive Federal control nor prevent them from engaging in legitimate cooperative activities.

As to Federal regulation of insurance, I must admit that I am somewhat less sanguine now than I was last summer when I first suggested that Congress consider repealing McCarran-Ferguson. We are seeing again that too familiar urge of Congress to regulate anything that works—airlines, trucks, banks, and doctors.

Would the Reagan Administration support regulation of insurance at the Federal level? I think not. What happens after Ronald Reagan? I do not know, but the antideregulation actions of some Members of Congress are a justifiable cause for concern.

As to necessary joint activity among insurers, recent Supreme Court cases have held that horizontal agreements are lawful if they truly enhance efficiency. Perhaps because the insurers have been free of the antitrust laws for so long, they have a warped view of its strictures. I can assure you, however, that the FTC, Justice Department, and the courts understand how to distinguish between competitive and anticompetitive behavior.

I do not want to leave the impression that repeal of McCarran-Ferguson would correct many of the government induced infirmities that presently afflict the insurance market. For example, as my written testimony points out, some States unwisely restrict the types of firms that can offer preferred provider organizations as innovative health care delivery systems.

The Commission could encourage the State regulatory agencies to correct these errors, but the 1980 Improvements Act bars us from obtaining the detailed knowledge of the industry necessary to be effective competition advocates. Thus, the Commission's response to your question about the repeal of the study restriction is simple and unanimous: The sooner, the better.

I am pleased to report that the Senate is apparently beginning to see the benefits of FTC insurance studies. Its version of our reauthorization bill directs the Commission to study the marketing of health insurance to the elderly and the causes of rate increases for property and casualty insurance. We welcome the opportunity to apply our expertise to these important issues.

Mr. Chairman, I might add that the Commission's lack of information about the insurance industry precludes me from discussing a number of the topics that your letter listed.

Free markets are the foundation of both our economic prosperity and our political freedom. There is broad agreement across the philosophical spectrum that exemptions from the antitrust laws are undesirable. The insurance exemption, from the antitrust laws in particular, has come under increasing attack. Such groups as the National Commission for the Review of Antitrust Laws and Procedures and the National Association of Attorneys General have called for its repeal. The time for congressional action is now.

Thank you. I'd be happy to answer any questions you or other members may have.

[Mr. Oliver's prepared statement follows:]

PREPARED STATEMENT OF HON. DANIEL OLIVER, CHAIRMAN, FEDERAL TRADE COMMISSION

Mr. Chairman and Members of the Committee:

Thank you for this opportunity to testify on "Proposed Solutions to the Liability Insurance Crisis." I will focus my testimony on the McCarran-Ferguson Act, the first of the seven issues that Chairman LaFalce's letter identified. In my view, repeal of this unfortunate law is long overdue. Exposing the insurance industry to the brisk winds of competition can only serve to benefit consumers and promote the common welfare. Of course, these benefits will be available only if we permit the industry to operate unimpeded by any federal restraints other than the antitrust laws. Repeal of the existing Act should not be used as an excuse for any new federal regulation. My strong opposition to any such regulation should not surprise you.

The broad antitrust immunity enjoyed by the insurance industry under the McCarran-Ferguson Act is both undesirable and unnecessary. The exemption is undesirable because, by blunting some forms of competitive behavior, it denies consumers the best array of insurance services at the lowest possible cost. The exemption is unnecessary because application of the antitrust laws is in no way inconsistent with either desirable industry cooperation or effective state regulation.

Before I develop these points, I must note two caveats. First, because the FTC Improvements Act of 1980 prohibits the Commission from studying the insurance industry without prior Congressional authorization, the Federal Trade Commission has not conducted a comprehensive review of the industry in recent years. We therefore lack detailed knowledge of current conditions,

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*The views expressed herein are those of Chairman Oliver and do not necessarily reflect those of the Commission or any of its members or staff.

including whether a liability crisis exists. For this reason, I will not address several of the issues listed in the letter of invitation. Nonetheless, what we do know from existing studies and from our enforcement activities indicates that the exemption is unjustified.

Second, although the Improvements Act constrains our authority to study insurance, it left intact our authority to challenge conduct by insurers that is not immunized under McCarran-Ferguson. In recent years, we have accepted several consent agreements prohibiting boycotts of nurse midwives by insurers,[1] and another prohibiting boycotts of insurers by agents.[2] Our staff is currently investigating other industry practices that may fall outside the exemption, but because the investigations are nonpublic, I cannot discuss further our current enforcement initiatives.

The McCarran Ferguson Act Is Undesirable

I start from the premise that, in the words of the Supreme Court, "the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress."[3]

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[1] State Volunteer Mutual Insurance Co., 102 F.T.C. 1232 (1983).

[2] Independent Insurance Agents of America, Inc., C-3197 (August 25, 1986); Independent Insurance Agents Association of Montana, C-3199 (August 25, 1986); Independent Insurance Agents and Brokers of California, C-3198 (August 25, 1986).

[3] Northern Pacific Railway v. United States, 356 U.S. 1, 4 (1958).

We rely on the free market to ensure that sellers will offer products and services with the best mix of price, quality, and other characteristics that consumers demand. The purpose of the antitrust laws is to prevent unwarranted interference with competitive market forces. The McCarran-Ferguson Act exempts the "business of insurance" from antitrust scrutiny, provided the conduct at issue is "regulated by state law" and does not involve a boycott, coercion, or intimidation.

Exemptions from the antitrust laws are disfavored, and the Supreme Court interprets them narrowly for that reason. In construing the McCarran-Ferguson Act, the Court has limited the "business of insurance" to activities directly involved in underwriting and spreading of risk.[4] Even as narrowly interpreted, however, the Act protects from normal antitrust scrutiny many activities that may injure consumers. For example,, the McCarran-Ferguson Act protects all manner of price fixing. Agreements among insurers to limit consumer options by using only certain policy forms and classification plans are also immunized. Likewise, the Act allows insurers to divide customers and territories among themselves, and to impose uniform terms upon agents.

The McCarran-Ferguson Act purports to ameliorate its adverse effects by conditioning immunity on the existence of state regulation. Unfortunately, the courts have interpreted the Act's

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[4] Union Labor Life Insurance Co. v. Pireno, 458 U.S. 119 (1982); Royal Drug Co. v. Group Life & Health Insurance Co., 440 U.S. 205 (1979).

"regulated by state law" requirement very broadly, so that even a cameo appearance by the state will cloak private action with immunity. Thus, some cases have held that the mere existence of a general scheme for insurance regulation constitutes sufficient state involvement to immunize a broad range of practices, including activities that the state has never directly authorized or even considered.[5] Indeed, courts have held that even where the state expressly prohibits a practice, the practice is "regulated" and thus exempt.[6] This rule is a bizarre way to further the interests of the states! As the National Commission for the Review of Antitrust Laws and Procedures pointed out eight years ago:

> Under the prevailing interpretation of McCarran-Ferguson, insurance company activities may be exempted from the coverage of the antitrust laws by the mere presence of a state regulatory scheme, without regard to whether these regulatory powers have been utilized to supervise the industry effectively. As a result, various types of collective insurance company behavior as a practical matter, are wholly free from control by either state regulation or the federal antitrust laws.[7]

Mr. Chairman, I believe it is not cynical to suspect that at least some insurers have taken advantage of McCarran-Ferguson immunity to harm consumers. Indeed, the courts have dismissed a number of private actions on McCarran-Ferguson grounds. These cases involved allegations of anticompetitive activities lacking any redeeming social benefit. For example, one court dismissed a suit claiming that 31 insurers had conspired to deny compensation for lost future earnings to individuals killed in car accidents. The plaintiffs alleged that the defendant insurers had taken concerted action to conceal claimants' rights and to refuse to offer coverage for future earnings.[8] In another dismissed suit, an asbestos manufacturer claimed that several insurers had conspired to deprive it of the full indemnification and litigation defense services that its policies provided. The suit also alleged a conspiracy to impose fraudulent policy interpretations on insureds and to limit the benefits that insurers would offer.[9] I do not know if the plaintiffs in these cases could have proven antitrust law violations, but the McCarran-Ferguson Act denied them the chance to try. Additionally, the Commission's Bureau of Competition recently closed an investigation involving anticompetitive activities by health insurers because it concluded that the McCarran Act immunized the conduct.

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[5] Ohio v. Ohio Medical Indemnity, 1976-2 Trade Cas. (CCH) Par. 61,128 (S.D. Ohio 1976).

[6] Crawford v. American Title Insurance Co., 518 F.2d 217, 218 (5th Cir. 1975); see St. Paul Fire & Marine Insurance Co. v. Barry, 438 U.S. 531, 552 n. 24 ("prohibitory legislation" coupled with "an enforcement scheme of administrative supervision" constitutes regulation by state law).

[7] Report of the National Commission for the Review of Antitrust Laws and Procedures 226 (1979) ("NCRALP Report").

Besides encouraging attempts by insurers to fleece consumers, the McCarran-Ferguson Act wastes resources. Even when consumers have a strong antitrust case against insurers, they must absorb high litigation costs to cut through the thicket of unfounded McCarran-Ferguson defenses that insurers raise.

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[8] Grant v. Erie Insurance Exchange, 542 F. Supp. 457 (M.D.Pa. 1982), aff'd, 716 F.2d 890 (3rd Cir. 1983), cert. denied, 464 U.S. 938 (1983).

[9] UNR Industries v. Continental Insurance Co., 607 F. Supp. 855 (N.D.Ill. 1984).

The McCarran-Ferguson Exemption Is Unnecessary

According to insurers, their industry is so different from others that it deserves a special dispensation from the nation's antitrust laws. Of course, almost every industry has its own problems that can be cited to support special protection from the rigors of competition. The automobile industry, like other basic industries, argues for protection from foreign competition. The beer industry presses for the right to establish exclusive dealing arrangements even in situations where such arrangements would be anticompetitive.

Fortunately, Congress has rejected many of these special interest appeals. Unfortunately, however, Congress has yielded to many others, granting antitrust immunity not only to the insurance industry, but also to agricultural cooperatives (which often fleece consumers under the cover of marketing orders), labor organizations, ocean shipping conferences, and others. All special interest exemptions from the antitrust laws deserve Congressional scrutiny.

Forty years ago, the insurance industry managed to persuade Congress that the McCarran-Ferguson Act was essential, both to preserve the states' autonomy to regulate and tax insurance, and to permit beneficial cooperation among insurers. The tragic irony -- for consumers -- is that McCarran-Ferguson simply is not necessary to accomplish any of those goals. States may regulate insurers with or without McCarran-Ferguson. And the forms of insurer cooperation needed for efficiency are perfectly legal under the antitrust laws.

Federalism

Insurers originally cited federalism as a justification for McCarran-Ferguson. In 1869, in Paul v. Virginia,[10] the Supreme Court had held that insurance was exempt from federal regulation. To the industry's shock, the Court reversed itself in 1944, in South-Eastern Underwriters.[11] That case upheld a Sherman Act indictment charging that a large group of insurers had used a rating organization to fix fire insurance premiums.

The decision created an uproar -- or rather the insurers did. Panic ensued as insurers told their Congressmen that state taxation and regulation of insurance would no longer be constitutional. Frankly, I do not understand how anyone made these arguments with a straight face. Maybe no one ever did. Today, certainly, no one would seriously argue that the antitrust exemption of the McCarran-Ferguson Act is needed to authorize state taxation or state regulation of insurance. The National Association of Insurance Commissioners was simply wrong when it argued, in its February testimony before the Senate Judiciary Committee, that "[t]he states' authority to regulate the industry dissipates if McCarran is repealed" because "federal preemption may occur."[12] After all, many other state-taxed and state-regulated businesses are subject to the federal antitrust laws, without anyone noticing any inherent conflict.

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[10] 75 U.S. (8 Wall.) 168 (1869).

[11] United States v. South-Eastern Underwriters Ass'n, 332 U.S. 533 (1944).

Moreover, as the Supreme Court's 1985 Southern Motor Carriers[13] decision illustrates, the state action doctrine lives -- some would say prospers. Repeal of McCarran-Ferguson would not change the states' role as the primary regulators of insurance. The Senate testimony of both the National Conference of State Legislatures and the National Association of Attorneys General reflect recognition by the states of this fact. Even after repeal, the states would still be able to regulate insurance -- even in ways that would harm consumers -- provided they clearly articulated a policy to displace competition and actively supervised the results.

In some states, the present legislative and regulatory framework probably would satisfy the "state action" standard. Elsewhere, however, the regulatory framework might not qualify and "state action" immunity would not attach. If those states wished to protect the anticompetitive activities that now occur, they would have to amend their regulatory frameworks -- and do so in public. In the process, they might have to confront openly the question of why insurance companies should be permitted to fix prices -- a practice ordinarily regarded as harmful. Whatever the result, consumers would gain from a public review of this question.

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[12] Testimony before the Senate Judiciary Committee, at 18 (February 18, 1987).

[13] Southern Motor Carriers Rate Conference, Inc. v. United States, 471 U.S. 48 (1985).

Today, insurers no longer focus very much on the sort of federalism argument that was made in 1944. Playing on the public's increasing and justified aversion to excessive federal regulation, the American Council of Life Insurance and the Health Insurance Association of America told Senator Metzenbaum in February that although the goal of his legislation repealing McCarran-Ferguson "may not be to create a giant federal regulatory structure, we are convinced that that is what will happen."[14] I can assure you that I would be the first to oppose any additional federal regulation. As an advocate of free markets, I would be disappointed if repeal of McCarran produced merely an alternative situation -- unnecessary federal and state regulation -- in which consumers are denied the benefits of competition.

Let me say that I understand the argument. When I first suggested, last summer, that I thought we should consider repeal, I also said the possibility of federal regulation of insurance seemed unlikely. I would like to think that is still true, but I am now less than certain. We are seeing again that too-familiar urge of Congressmen to regulate anything that works -- airlines, trucks, banks, doctors. No matter how well the free market works, some Congressmen think they make it better.

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[14] Statement of Robert Seiler before the Senate Judiciary Committee, at 3 (February 18, 1987).

Would the Reagan administration would really support federal regulation of insurance? Now that is unlikely. What happens after Ronald Reagan? I don't know. But some political candidates are regulators. Others are deregulators. We should be sure the voters know which are which, and be sure they encouraged to select the proper group on election day.

"Ruinous Competition"

There is another argument that insurers make against repeal. They claim that antitrust exposure will prevent insurers from engaging in legitimate cooperative activities. I find this argument especially wrong-headed. Perhaps because insurers have been free of antitrust scrutiny for so long, they are ignorant of its strictures. But as the Chairman of one of the two federal agencies that enforces the antitrust laws, I can assure you that the joint activity argument is a straw man. Enforcement agencies and courts are well aware that some forms of joint action enhance, rather than restrict, competition, and they are quite sophisticated at distinguishing harmful agreements from beneficial agreements.

Mr. Chairman, you can expect insurers to claim that they need immunity in order to engage in joint rate-making. They did so before the Senate Judiciary Committee. Their justifications for joint rate-making, however, are unpersuasive. Some have said that price fixing preserves insurer solvency and assures that money will be available to pay off policy-holders. But numerous other kinds of firms make risky contractual commitments and manage to pay them off without setting up cartels. Moreover, state legislatures have adequate authority to address any genuine solvency problems by auditing the companies, requiring loss reserves, and establishing state guarantee funds.

I also reject claims that competition will hurt policyholders. The American Council of Life Insurance and the Health Insurance Association of American have testified that the so-called "liability crisis" was and is partly a result of "excessive competition" among insurances.[15] Other industries made similar arguments prior to deregulation and exposure to the antitrust laws. The evidence from these industries demonstrates that consumers benefit from competition. The Commission is particularly familiar with the recent experience of the health professions, which have been subject to market forces for only a decade. Although doctors may be working harder for a bit less money, they are by no means starving. More importantly, their patients still receive good care, and are able to choose from a r broader array of price and service options than before.

In recent years, many states have recognized the benefits that flow from competition, and have given their insurers more freedom to set their own rates. Indeed, in Illinois, rate bureaus are limited to statistical collection and analysis. From listening to the industry, you might suppose that Illinois insurers went bankrupt once they were deprived of their cartel. The National Commission for the Review of Antitrust Laws and Procedures, however, found no harmful effects.[16] Competition poses no risk to the solvency of the vast majority of insurers.

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[15] Id. at 2.

So, insurers now make an alternative argument and assert that they must pool loss data to make actuarially accurate projections. As best as I can determine, this claim may well be true. But the National Association of Insurance Commissioners was simply wrong when it testified that "[t]he application of antitrust laws to some of the current rating activities such as the pooling of statistics and development of manuals and forms may eliminate benefits which result in cost savings to the consumer."[17] Under current caselaw, agreements among competitors that promote competition and thereby benefit consumers are lawful.[18]

The problem arises when insurers go beyond collecting and aggregating loss data, and collectively determine rates or coverages to be offered. It is such joint rate-setting or determination of coverage, and not the joint collecting of data, that is anti-competitive and harmful to consumers. In February, the American Insurance Association and the National Association of Insurance Commissioners told the Senate Judiciary Committee that the industry needs to agree collectively on prices, as well as share loss data. I defy them, or any other group of insurers, to explain to Congress how consumers now benefit from price-fixing, or would be harmed by competition. Repeal of the McCarran-Ferguson immunity would permit insurers to use jointly collected data to determine their own rates and coverages individually, in competition with one another. The National Association of Insurance Legislators may have been right when it testified that "replacement of McCarran-Ferguson with the Federal Anti-trust laws could bring about price wars that no state government, no federal agency and no United Nations peace-keeping force could control."[19] I say, bring on the price wars, because I believe the casualties of any price war would be the excessive profits of the insurers, not consumers. On the contrary, consumers are always the beneficiaries of price wars.

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[16] NCRALP Report, at 233.

[17] Statement before the Senate Judiciary Committee, at 27 (February 18, 1987).

[18] E.g., Broadcast Music, Inc. v. Columbia Broadcasting System, 441 U.S. 1 (1979).

At this point, I would like to discuss briefly S. 804, a compromise bill proposed by Senator Simon, because I expect similar legislation to be introduced in the House. This legislation would repeal the general antitrust exemption for the insurance industry, but would retain immunity for a long list of specific types of agreements.

I oppose this approach and urge that you reject it. First, although most activities that S. 804 would exempt involve joint research and information processing, a number have the potential to harm consumers. For example, the bill would immunize joint preparation of "pure premium rates, and rating guidelines and rating schedules for insurance risks . . ." and the collection and dissemination of "past and current prices of individual insurers . . . ."[20] Despite safeguards designed to prevent price fixing, these provisions might well facilitate anticompetitive pricing.[21] Second, some courts would interpret the list of immune activities very broadly, reasoning that since the antitrust laws already condone efficient collaborations, Congress intended S. 804 to authorize certain harmful activity.

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[19] Statement of Donald M. Halperin before the Senate Judiciary Committee, at 2 (February 18, 1987).

Ever since passage of the Sherman Act in 1890, the operative premise underlying our antitrust laws has been that free markets work better than heavily regulated markets. Firms that want special treatment for their industry should have to justify in detail any exception to the general rule. Insurers have not made a persuasive case over the past 40 years, and I doubt they will be able to do so this year. Congress has a duty to correct the mistaken notion that there's something about the insurance industry that make competition principles inapplicable to it.

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[20] S. 804, § 3.

[21] See, e.g., United States v. Container Corp. of America, 393 U.S. 333 (1969). Moreover, the bill would immunize insurance industry agreements relating to preparation of policy forms, coverages, classifications, and statistical plans. These provisions explicitly authorize insurers to eliminate competition respecting the types of coverages that they offer. Not only do the antitrust laws generally prohibit such agreements, but one of the cases that I discussed earlier involved a concerted refusal to offer coverage for future earnings. See note 8, supra.

Anticompetitive State Regulation

Although repeal of McCarran-Ferguson may allow us to end some abuses, I do not want to suggest that all anti-consumer activity in the insurance industry would immediately end. Regrettably, many state governments have passed laws and issued regulations that injure consumers by restricting competition.

Let one example illustrate: Some states have prohibited insurers from establishing certain kinds of "preferred provider organizations," or PPOs. These organizations are an innovative approach to lowering health care costs. Georgia allows Blue Cross and Blue Shield to operate PPOs, but bars commercial insurers from doing so. Ohio thinks Georgia has it backwards: it bars Blue Cross and Blue Shield and other similar plans from having PPOs, but allows commercial insurers to offer them. Montana believes it has a better idea and prohibits PPOs entirely. I believe that the market will do a much better job than the states of deciding who is best able to provide PPO coverage.

I recognize that some state regulation is designed to assure insurer solvency and insurance availability. The wisdom of such regulation need not be addressed today. However, other forms of state government interference in the insurance industry unquestionably harm consumers. Thus, while repeal of McCarran will help your constituents, it will not correct many other government-induced infirmities that afflict the insurance market.

Unfortunately, the Commission has been of little help to consumers in this regard. In many other industries, the Commission or its staff file comments with federal and state agencies to suggest ways of solving regulatory problems with minimum disruption of market competition and maximum benefit to consumers. Frequently, the Commission is the only voice for consumers among the clamor of special interests. As I noted earlier, however, the "Improvements Act" bars the Commission from studying the "business of insurance" without the express authorization of either the House or Senate Commerce Committee.[22] Our lack of authority to collect and analyze information about the industry hobbles our capacity to advocate consumer interests in the insurance industry. In the past, the Commission has expressed it unanimous support for elimination of the study restriction.

I am pleased to report some evidence that Congress is beginning to focus on the anticonsumer effects of the study restriction. Although our reauthorization bill retains the blanket prohibition, it directs the Commission to undertake studies of the marketing of health insurance to the elderly and of the causes underlying increased property and casualty insurance rates. I welcome the opportunity to serve the Congress and the American public by applying our considerable legal and economic expertise to these important questions.

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[22] We have in fact undertaken three such studies. They analyzed consumer information regarding (1) auto insurance and (2) life insurance and (3) collective pricing of auto insurance. Each was released in 1985.

Let me conclude by discussing a more serious threat to the Commission's ability to speak for consumers. The Senate-passed bill reauthorizing the Commission requires the reallocation of $850,000 from our headquarters units (especially the Bureau of Economics) to our regional offices. I oppose this idea. Let me emphasize that the Commission is united in its support for effective regional offices. Indeed, at our request, the Commission's Executive Director recently forwarded to us a comprehensive study of the existing resource allocation between the regions and headquarters. I would urge that Congress permit the Commission to review that study and determine what action should be taken before legislating a solution that may be unwise.

I myself see no evidence that consumers would benefit from diversion of resources away from the Bureau of Economics to the regions. In this regard, I believe that there may be some misconceptions about the work of our economists. Most of them directly support our law enforcement activities, staffing every antitrust investigation and major consumer protection matter. At our current staffing levels, our economists just barely can cover their workload.

To the extent that our economists conduct industry studies, I take issue with any suggestion that such activity conflicts with our mission. Economic research has long been a major feature of our Congressional mandate. Section 6 of the FTC Act itself authorizes the Commission to investigate economic behavior and report its findings to Congress, the President, and the public. This authority is separate from our enforcement authority in Section 5 of the Act. Restraints on the Commission's ability to study the effects of government regulation and the behavior of firms merely serve to insulate special interests from facts they don't want to hear and, more importantly, from facts they don't want you or your constituents to hear. For these reasons, I urge that you oppose efforts to mandate reallocation of Commission resources.

Conclusion

There is broad agreement across the philosophical spectrum that exemptions from the antitrust laws are undesirable. It seems clear that the welfare of the American consumer stems in large measure from the greater efficiency that competition creates. Moreover, as Mr. Justice Black observed, competition provides "an environment conducive to the preservation of our democratic political and social institutions."[23] Free markets are the foundation of both our economic prosperity and our political freedom. We make exceptions to the laws that ensure free markets at our peril.

The insurance exemption from the antitrust laws, in particular, has come under increasing attack. Experience and logic demonstrate that the exemption is adverse to consumers and is unnecessary to protect legitimate industry conduct. Eight years ago, the National Commission for the Review of Antitrust Laws and Procedures called for repeal of the exemption. More recently, so has the National Association of Attorneys General. The time has come for Congress to act.

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[23] Northern Pacific Railway, 356 U.S. at 4.

Chairman LaFalce. Thank you very much. Before we begin our questioning, we will hear next from Mr. Charles Rule, the Acting Assistant Attorney General in charge of the Antitrust Division.

TESTIMONY OF CHARLES F. RULE, ACTING ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Mr. Rule. As you've indicated that my full statement will be in the record, I will summarize that today.

Mr. Chairman, members of the committee, I'm pleased to appear this morning to discuss the possible repeal of the McCarran-Ferguson Act and the availability and affordability of liability insurance.

While the committee is considering in these hearings various proposed solutions to the existing problem, we at the Antitrust Division feel qualified to discuss only the first, which is repeal or modification of the antitrust exemption granted to the business of insurance by the McCarran-Ferguson Act.

I have testified twice in the recent past on this issue before the antitrust subcommittees of the Senate and the House Judiciary Committees, and I can only reiterate for this committee what I have said on those occasions regarding the costs and benefits of repeal. More directly related to the topic of today's hearing is our position contained in those statements that, in our view, the antitrust exemption of the McCarran-Ferguson Act is not responsible for causing the present crisis in certain lines of liability insurance, and that, therefore, its repeal will not solve the problem.

But as you've indicated, Mr. Chairman, the Department generally opposes antitrust exemptions and believes the burden should be on those who advocate such exemptions or oppose the repeal of those like the McCarran-Ferguson Act that are currently on the books.

First, while there may be justification for repealing the antitrust exemption in the McCarran-Ferguson Act, let me leave no doubt that the administration would oppose very strongly any effort to repeal the rest of the McCarran-Ferguson Act; that is, that part of the McCarran-Ferguson Act that makes it clear that the business of insurance is to be taxed and regulated by the States, and that Federal Government action will be deemed to displace the States only when explicitly stated by Congress.

We think that's appropriate. We think the States should have preeminent authority for taxing and regulating insurance. We believe that any attempt to "nationalize," even partially, insurance regulation would be a serious mistake.

Second, as to the antitrust exemption in the McCarran-Ferguson Act, if the question were today whether to enact such an exemption, my answer would be no. And it would be a rather easy answer to arrive at. The State action doctrine has been expanded over the last 40 years so that the application of the antitrust laws does not interfere and should not interfere with legitimate State regulation of insurance or any other industry.

Moreover, the antitrust laws are interpreted today in such a way as a result of cases like BMI/ASCAP and NCAA, cases that have been decided in this decade, that the courts would not likely condemn legitimate cooperative activities in the insurance industry, such as the collection and sharing of actuarial data. Therefore, there is little reason—or there would be little reason—for the insurance industry to fear the antitrust laws. And if they had gotten used to it over time, certainly it would be very difficult for them to argue that the antitrust laws, I think, would be interfering with their business today.

Of course, the question before us is not whether to enact an antitrust exemption, but whether to repeal the one that exists. In many ways that is a much more difficult question to answer because such a repeal entails costs in terms of disruption to State regulation and the industry, while a repeal is unlikely to yield significant competitive gains.

First, let me briefly explain the costs. Costs in our view are really two in nature. First, as a result of the repeal, there is a danger that the States may decide to increase the regulation of the insurance industry in order to provide the State action defense to the States' insurance industry. There has been a very positive and beneficial trend, we believe, in the States toward greater competition, file and use schemes, that sort of thing, that have provided benefits to consumers. And it would be unfortunate if, in an effort to bring about more competition in the industry by repealing the antitrust exemption, we had the opposite effect of having the States clamp down even more on competition within their borders.

Second, and perhaps more significant, or at least one that Congress can deal with, repeal will likely create a great deal of uncertainty, at least in the short term, about the legality of efficient cooperative arrangements in the insurance industry. Even if those arrangements are ultimately found legal, the uncertainty in litigation costs could chill these beneficial activities.

As I mentioned, there is not much one can do about the concern of increased State regulation. And I think there is some reason to believe that because of the way the State action doctrine has developed, the increase in regulation will not be terrifically great. But I don't think there is anything that you can do about that with legislation.

You can, however, do something about the uncertainty of the legality of beneficial cooperative activities. You can do something about that by writing a statute that limits significantly the uncertainty by stating what cooperative arrangements will be legal and how they will be treated under the law.

Against these costs, which as I say——

Chairman LaFalce. One of the bills I've introduced since 1978 does exactly that.

Mr. Rule. And a number of them have, yes.

The benefits on the other side, against which these costs have to be weighed, are not terribly tremendous from what we can see in the evidence that's available at this time.

First of all, the industry as currently structured is very competitive. It's unconcentrated. Barriers to entry appear to be low to nonexistent, and the product is heterogeneous. Collusion, even in the absence of an antitrust prohibition, is very unlikely.

What evidence we have does not support claims that the current crisis in affordability and availability of certain lines of insurance is due to collusion. First of all, in the relevant period, profits appear to have been declining. One would expect profits to increase in the presence of collusion.

Moreover one wonders why, if the McCarran-Ferguson Act has been around for 40 years or more, the insurance companies have taken so long to figure out how to collude and then done so only in selected lines.

If there is a reason to repeal the antitrust exemption, it appears to us that the reason is to, in effect, dispense with the issue, to get rid of another industry-specific exemption so that the true causes of the affordability and availability crisis can be dealt with.

From what we have seen, it appears that the true cause—this doesn't really tell you the root of the cause, but it shows in the statistics what seems to be the cause—is the higher payouts and greater uncertainty concerning payouts the insurance industry is facing, particularly, in the crisis lines. The evidence shows that affordability has suffered from a deterioration of cost-to-premium ratios, and also that there has been an increased variability with regard to the higher risk, that is, payouts that the insurance companies have had to make. And those seem to be the cause.

Chairman LaFalce. Where is this in your prepared testimony, sir?

Mr. Rule. This would be towards the end of the testimony. If you look on 12 and 13—13 and 14. And if you would like, Mr. Chairman, we have done a——

Chairman LaFalce. I am looking at 12 and 13 and 14.

Mr. Rule. Look at the bottom of 13 and then carry over to 14. The paragraph there.

Chairman LaFalce. All right. Thank you.

Mr. Rule. At any rate, there may be several causes for that. I am not an expert, and so I really cannot address it. But those are the statistics that we have looked at, our economists have studied, and that seems to be an explanation. And those factors, that is, the deteriorating cost-to-premium ratios and the increased variability, are not the sort of evidence that one would find if one thought that collusion was the reason for this affordability and availability crisis.

Having said that, Mr. Chairman, I will conclude, but I will be happy to answer your questions or questions of any of the members.

[Mr. Rule's prepared statement follows:]

PREPARED STATEMENT OF CHARLES F. RULE, ACTING ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Mr. Chairman and Members of the Committee:

I am pleased to appear this morning to discuss the possible repeal of the McCarran-Ferguson Act 1/ and the availability and affordability of liability insurance. While the Committee is considering in these hearings various proposed solutions to the existing problems, we at the Antitrust Division feel qualified to discuss only the first, which is repeal or modification of the antitrust exemption granted to the business of insurance by the McCarran-Ferguson Act. I have testified twice in the recent past on this issue before the antitrust subcommittees of the Senate and House Judiciary Committees, and I can only reiterate for this Committee what I have said on those occasions regarding the costs and benefits of repeal. More directly related to the topic of today's hearing is our position, contained in those statements, that in our view the antitrust exemption of the McCarran Act is not responsible for causing the present crisis in certain lines of liability insurance, and that therefore its repeal will not solve the problem.

The McCarran-Ferguson exemption is a long-standing, industry-specific antitrust exemption. As I will discuss in detail in a moment, we believe that there would be no justification today for the enactment of a new antitrust exemption for the business of insurance. There are, however,

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1/ 15 U.S.C. §§ 1011-15.

possible costs associated with repealing the one we have--costs that it may well be necessary or appropriate to bear, but costs nonetheless. The possibility of having to incur such costs when an antitrust exemption finally is repealed is one very good reason not to create questionable exemptions in the first place.

Prior to 1944, regulation of insurance was exclusively the province of the states, under the prevailing view that insurance was not "commerce." In that year the Supreme Court decided the South-Eastern Underwriters case 2/ and held that the insurance business was within the regulatory power of Congress under the commerce clause and thus was subject to the antitrust laws. South-Eastern Underwriters was perceived as posing three threats to state insurance regulation. First, it was feared that the commerce clause would unduly limit the power of the states to regulate and tax insurers on the theory that such regulation and taxation imposed an impermissible burden on commerce. Second, there was apprehension that state regulation of insurance rates would be held invalid because of its inconsistency with the Sherman Act. Finally, there was a concern that efficiency-enhancing joint insurer activities would be held invalid under the antitrust laws.

2/ United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533 (1944).

Congress enacted the McCarran-Ferguson Act to remove these perceived threats. Section 1 of the Act declares that regulation and taxation of the business of insurance by the states is in the public interest and that silence on Congress's part shall not be construed to impose any barrier to such state activity. Section 2(a) provides that the business of insurance and those engaged therein shall be subject to state laws relating to the regulation and taxation of insurance. Section 2(b) reinforces that statement by declaring that no congressional enactment shall be construed to "invalidate, impair, or supersede" any state law enacted for the purpose of regulating or taxing the business of insurance unless that congressional enactment specifically relates to the business of insurance. Finally, sections 2(b) and 3(b) of the Act declare that, except for agreements to boycott, coerce or intimidate, or acts of boycott, coercion or intimidation which remain fully subject to the Sherman Act, the "business of insurance," to the extent it is regulated by the states, is exempt from the antitrust laws.

As I mentioned earlier, I have recently testified before the Senate Antitrust, Monopoly and Business Rights Subcommittee concerning S. 80, a bill that would repeal the McCarran-Ferguson Act in its entirety. Not only would the Act's explicit antitrust exemption provisions be repealed, but those sections of the Act that confirm the ability of the states to regulate and tax the business of insurance, and that govern the construction of other federal laws that do not specifically relate to the business of insurance, would also be repealed.

As expressed in my prior testimony, we are concerned that enactment of S. 80 could have unintended effects on state regulation of insurance. While states appropriately are examining the way in which they regulate the business of insurance, and moving toward less regulatory regimes that recognize the benefits of competition, the authority to regulate should remain at the state level. The Department would be very much opposed to any movement, or appearance of movement, toward the federalization of insurance regulation. Repeal of anything other than the explicit antitrust exemption in the McCarran-Ferguson Act could create confusion and litigation concerning state insurance regulation and taxation under the Supremacy and so-called "Dormant Commerce" clauses of the Constitution.

Turning to antitrust issues, the Department has always been and remains opposed to general or industry-specific antitrust exemptions in the absence of a strong showing by those who advocate immunity of an actual or potential conflict between the antitrust laws and some other societal goal. The nation's fundamental economic policy of competition promoted by the antitrust laws maximizes consumer welfare and the efficient allocation of societal resources.

At least in recent years, the antitrust enforcement agencies and the courts have interpreted the antitrust laws in ways that do not inhibit any practice that is not truly anticompetitive. Such recent Supreme Court decisions as General Dynamics, 3/ GTE Sylvania, 4/ and Broadcast Music 5/ make clear that sound economically-based analysis is required before an antitrust challenge will be sustained. In those and other decisions the courts have resisted over-zealous application of the per se rule to alleged restraints of trade whose actual competitive effects are ambiguous. While Congress in recent years has recognized the need for certain clarifications of the antitrust laws and for moderation of their penalties in certain contexts, 6/ the inherent flexibility of those laws and the importance of the competitive process they protect argue strongly against antitrust exemptions that are not clearly and convincingly justified.

Were an antitrust exemption for the business of insurance a matter of first impression today, we do not believe such an exemption could be justified. First, there is no inherent need for a special statutory antitrust exemption in order for the

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3/ United States v. General Dynamics Corp., 415 U.S. 486 (1974).

4/ Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977).

5/ Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc., 441 U.S. 1 (1979).

6/ See, e.g., the Export Trading Company Act of 1982, 15 U.S.C. § 7; the National Cooperative Research Act of 1984, 15 U.S.C. §§ 4301-05; and the Local Government Antitrust Act of 1984, 15 U.S.C. §§ 34-36.

states to regulate the business of insurance, or for that matter any other business. Under the "state action doctrine," which was undeveloped in 1945 but has been the subject of many subsequent Supreme Court decisions, a state effectively may immunize what otherwise might be an unlawful restraint of trade through a clearly articulated, affirmatively expressed state policy to displace competition, coupled with active supervision of any private conduct that may be involved.

Second, the application of the antitrust laws to potentially efficiency-enhancing joint activities among competitors has become much more predictable--and much more favorable to such activities--than it was at the time the McCarran-Ferguson Act was enacted. Some forms of joint activity that might have been condemned under overly broad interpretations of the antitrust laws are now clearly permissible. Antitrust rules, as the courts articulate them today, are firmly based on principles of sound economics and can be adapted to any industry. It is possible, as I will discuss in a moment, that some legitimate joint insurer conduct might superficially be perceived as raising antitrust risks in the absence of statutory immunity, and thus that some clarification of the antitrust laws might be appropriate if the current McCarran-Ferguson exemption were repealed. Such a clarification, however, would be a far cry from exempting any truly anticompetitive conduct from the application of those laws.

While we therefore believe that there is no justification for the creation today of a new exemption for the business of insurance, the fact of the matter is that such an exemption has been on the books for 40 years, and the system of state regulation that it complements has been around even longer. Thus, repealing the exemption involves more than just removing from the statute books an antitrust exemption that we would not enact today. Relevant inquiries include whether there would be any significant costs associated with repealing the existing exemption and, if so, whether those costs would be more than outweighed by the benefits of doing so. We perceive some uncertainties associated with both of these issues that we believe warrant the Committee's attention.

Turning first to the possible costs of repeal, some uncertainty exists as to whether repealing insurance's antitrust exemption might indirectly and adversely affect the manner in which states would choose to regulate insurance. Such an effect might result from a perception that the state action doctrine, even as understood today, would not immunize some joint insurer conduct under some forms of state regulation, particularly state regulation that is neutral as to whether insurers participate in joint activity.

As I indicated above, there are two tests that must be met for state action immunity to be afforded to an alleged restraint on competition. First, the restraint must be the product of a "clearly articulated and affirmatively expressed" state policy to displace competition. Second, the state must actively supervise any private anticompetitive conduct. 7/ In its 1985 decision in Southern Motor Carriers, 8/ the Supreme Court held that a state need not "compel" private anticompetitive conduct in order for such conduct to be immune from antitrust liability as state action. In that case, state regulation of collective ratemaking by intrastate motor carriers was considered sufficient to establish the state action immunity. While Southern Motor Carriers suggests that under the state action doctrine at least some forms of state insurance regulation would protect concerted decisions among insurers from antitrust liability, states may regulate some insurer conduct in a manner that is sufficient to trigger the McCarran-Ferguson exemption, but not sufficient to provide state action immunity. Whether any particular, overall state regulatory scheme for insurance would satisfy the two-pronged test for state action immunity described above ("clear articulation," "active supervision") could be open to question if McCarran-Ferguson were repealed.

One response to this uncertainty, of course, is to say that the requirements for state action immunity under Southern Motor

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7/ See, e.g., California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 105 (1980), quoting City of Lafayette v. Louisiana Power & Light Co., 435 U.S. 389, 410 (1978) (opinion of Brennan, J.).

8/ Southern Motor Carriers Rate Conference, Inc. v. United States, 471 U.S. 48 (1985).

Carriers are the very tests that should apply to state insurance regulation, just as they apply to any other industry. One can well argue that any alleged competitive restraint among insurers that is sufficiently "private" in nature to be unprotected by the state action doctrine should be subject to antitrust scrutiny. However, it is conceivable that if the McCarran-Ferguson antitrust exemption were repealed, at least some states might fear that their regulatory schemes were too permissive to trigger the state action defense and might adopt less innovative, more anticompetitive approaches to insurance regulation in order to ensure the applicability of that defense. As Senator Metzenbaum noted in introducing S. 80, the recent trend in state regulation has been to permit freer competition among insurers. 9/ We would hope that that trend would not be adversely affected by a change in federal law that induces attempts to fortify state regulation in order to preserve antitrust immunity.

Some uncertainty also may exist with respect to the bounds of legitimate joint insurer activities related to rates charged by insurers. While it is true that antitrust law has evolved in recent years to avoid per se condemnation of joint activities that are on balance procompetitive--even in the face

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9/ 133 Cong. Rec. S. 342-44 (daily ed. January 6, 1987).

of spurious arguments that they constitute price fixing 10/--some collective activities that promote competition among insurers might unduly be deterred by perceived antitrust risk. Many desirable joint activities protected by the McCarran-Ferguson Act today are at least indirectly related to price, and might be subjected to antitrust challenge if insurance's antitrust exemption were simply repealed. While I believe those practices ultimately would be vindicated under careful judicial review as being in the interests of consumers, that vindication might take considerable time and engender some significant costs.

This uncertainty might be reduced by a repeal of the McCarran-Ferguson Act antitrust exemption accompanied by an attempt to state which legitimate cooperative activities would not be unlawful under the antitrust laws. This is the approach, for example, of Senator Simon's proposal, S. 804, and similar in concept to a proposal adopted by the National Commission for the Review of Antitrust Laws and Procedures in 1979. It would preserve an exemption for certain specified joint insurer activities--for example, collecting and disseminating loss data, preparing pure premium rate data and policy forms, and conducting various other forms of research and information distribution.

10/ See Broadcast Music, Inc. v. Columbia Broadcasting System, Inc., *supra* note 5.

There are, of course, potential difficulties with this approach. It may be difficult to describe in sufficient detail those cooperative arrangements that are lawful under the antitrust laws. Too broad a description could protect anticompetitive conduct, while too narrow a one could fail to eliminate considerable uncertainty. It also might be extremely difficult to develop an exhaustive list of legitimate arrangements that are intended to pass antitrust muster.

Antitrust uncertainty might further be reduced by phasing in application of the antitrust laws to the business of insurance. While such a phase-in could provide an appropriate adjustment period, it is not clear whether outstanding legal issues would be decided or even justiciable until after such a phase-in was complete.

There are also uncertainties associated with the potential benefits--essentially the promotion of competition--that would be derived from repealing insurance's antitrust exemption. Repealing that exemption may not make insurance significantly more widely available at lower prices. In particular, repeal does not seem likely to solve the crisis in certain lines of property/casualty insurance. We have not seen any direct evidence that collusion has produced this crisis, and the circumstantial evidence suggests that collusion is not the cause. Rather, the fault seems to lie in larger and larger payouts made by insurers under the present tort law system.

For a detailed discussion of this issue, I refer the Committee to a report issued last month by the Administration's Tort Policy Working Group entitled "An Update on the Liability Crisis." The Antitrust Division contributed to that volume by authoring the Appendix, entitled "The Crisis in Property-Casualty Insurance." I have submitted a copy of that Appendix to the Committee and ask that it be printed with my remarks in the record.

The structure of the property/casualty insurance industry is conducive to competition, not collusion. State rate regulation that may have facilitated collusion by requiring prior approval of rates and discouraging deviations from the rates established by rating organizations has largely been supplanted by state laws that allow free play for price competition.

The United States property/casualty insurance industry includes a very large number of underwriters--in the neighborhood of 1,000. 11/ No single firm or small group of firms dominates this industry: the eight largest property/casualty companies collectively account for only about a third of direct premiums written by property/casualty underwriters. Property/casualty underwriters are diverse in their methods of doing business: for example, some sell through agents, while others are "direct writers" who deal with insurance consumers through their own employees. While not all

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11/ Best's Executive Data Service A2-99-99 (1986).

companies do business in all states and most companies do not write all types of property/casualty coverage, we are not aware of any significant regulatory or other barriers that would prevent companies from moving quickly from one type of property/casualty insurance to another or from one state to another.

In these circumstances we would not expect to find effective collusion. Even if a substantial number of firms in a particular state could reach accord as to price by agreeing to adhere to the pricing schedule filed by a rating organization, it would be difficult for those firms to prevent outsiders from rapidly entering the market and offering a lower price to insurance consumers. Moreover, while defections from the collusive agreement would be easy to detect because of state laws requiring the filing of all rates, there is no readily apparent means of preventing those defections, at least in the large number of states that permit new rates to be used as soon as filed or even prior to filing.

Hence it seems highly probable that the property/casualty industry is in fact competitive, and that collusion is not responsible for the present availability and affordability crisis in certain lines of insurance. While the cause of the crisis is not entirely clear, it seems likely that the increase in the level of casualty loss payouts and expenses in these lines, and the increase in the variability of those losses and expenses, are major contributing factors to the crisis. If variability (that is, "risk") is very substantial, the premiums required to maintain solvency requirements might be so high that coverage would be unattractive to potential insureds. There would then appear to be an affordability crisis in the affected lines. Should variability be so great as to exceed the ability or willingness of insurers to cope with it, coverage might be unavailable at any price.

To summarize, Mr. Chairman, the Department of Justice remains opposed to the enactment of new antitrust exemptions or the continuation of those that may be outdated and unnecessary without a strong showing by the advocates of immunity that they are justified. We believe that the current, broad McCarran-Ferguson exemption for the business of insurance may well have outlived its usefulness, and we endorse the Committee's inquiry into the continuing need for it, at least in its present form. We believe, however, that there are some uncertainties associated with both the costs and benefits of repealing or modifying this longstanding exemption that warrant the Committee's inquiry and attention. We do not, however, believe that the McCarran exemption is responsible for causing the present crisis in certain lines of liability insurance, and its repeal or modification therefore will not solve the problem.

Mr. Chairman, that concludes my prepared remarks. I would be happy to answer any questions you or any members of the Committee may have.

Chairman LaFalce. Thank you.

I am going to refrain from asking questions until the other members have had an opportunity.

I do want to point out one thing though, Mr. Rule, with regard to the facts that you refer to at the bottom of page 13. We did have a hearing at one time where we had a representative from the Justice Department come, and we found that his facts were factless. And anybody worth his salt who has examined the facts used by the Justice Department to reach their conclusions would give an F if they were grading that Justice Department study. The Harvard Risk Management people, for example, said they would be embarrassed, absolutely embarrassed.

Now, maybe there are some new data.

Mr. Rule. Oh, I think there is. The study that we have done was only concluded in the last month or so, and it is based on what the economists in the Antitrust Division have done. It's based on A.M. Best's data, and we'll be happy to provide that. It is provided as an appendix to the recent publication, "An Update on the Liability Crisis," by the Tort Policy Working group.

Chairman LaFalce. We have examined that, although we have not had testimony on that. Based upon our examination, we do not find any improvement whatsoever. But we might have a hearing on that, in and of itself. But in all candor we found absolutely no improvement in that most recent study.

Mr. Lancaster. No questions at this time.

Chairman LaFalce. Mr. Hefley?

Mr. Hefley. No questions.

Chairman LaFalce. Mr. Bilbray?

Mr. Bilbray. No questions.

Chairman LaFalce. Mr. Martinez?

Mr. Martinez. Yes; I am a little confused. Maybe you can clarify.

I was in business for 21 years. I needed all kinds of liability insurance in my business. And I had one of the highest rated insurance risk businesses. And I shopped. This is in California. And I shopped and shopped and shopped. I couldn't find, on the bottom line variable, one difference between insurance companies, as to the rates they were charging and the coverage they provided. It depended on how much coverage I wanted. That established the rate, not the protection.

How can you say there isn't collusion? Every insurance company that I ever went to with the bottom line, when I analyzed all of the coverage I was getting and the amount of coverage for the different liabilities, I was paying the same price. It just depended who had the best reputation for payoff. That was my guiding light in making a determination. So, I don't understand that. I imagine that it is no different anywhere else.

One of the problems that exists now is that no insurance company is going to take a loss. If they have a claim, they are going to up that rate so that they make sure that in the end they come out with their margin of profit. I've always wondered, and I know a lot of people like me—and understand, this is coming from maybe a layman's position in the insurance business—I have always wondered how large insurance companies can offer these low interest rates for huge amounts of money if they weren't making a tremendous profit. And the consumer pays for it in the end.

Well, right now it is getting to the point where some cities in California—their premium on their insurance coverage is higher than their total budget, and they cannot afford it. Many of them have gone to self-insuring. And they find out under the premise of self-insuring, that they come out much better than dealing with an insurance company.

We talk about the reason of the crisis and the high costs, but we always avoid talking about the fact that, first, lawyers get the biggest percentage of a settlement, and that lawyers are usually engaged to make sure that a claimant gets the best adjustment they can. And in reality, that individual would get more if they just settled outright with the company, because even with the increased adjustment the attorney gets the extra money.

If it takes the government, State or Federal, to establish the amounts of money for any particular kind of a claim, then it should be done. That would eliminate the need for lawyers and that big expense. But nobody ever talks about those kinds of things.

All we talk about is how there is not collusion by the insurance company—I believe there is—and how there isn't anything they can do about it because the increase in the number of claims increases the rates.

The increase in the number of claims is preceded by an increase in the number of customers who pay premiums. So, where is the correlation? I don't understand.

Mr. RULE. Well, Congressman, as I indicated, I really can't speak to factors other than antitrust and the effect that the McCarran-Ferguson Act is having.

The reason that it is difficult to say that collusion is the cause of the crisis—and there is no doubt that there is a crisis; I am not here to say that there is not—but the reason that it is very difficult to lay that crisis at the doorstep of collusion is that where you have an industry of about 1,000 players where it is fairly easy for any one of them to move into any line of insurance, it would be very difficult, in fact, it would be very foolish, for a few of them to try to get together and collude because it would be very easy depending on the State regulatory scheme for the others—for the rest of their competitors—to come in and underprice them. And that is what competition is all about. After all, markets work many, many millions of times every day. And it is only a few of those operations that ever raise antitrust questions anyway. And it appears that the insurance industry is certainly competitively structured.

I would be happy to look at any other evidence that anybody has, and I would be happy to listen to any criticisms that people may have about the evidence that we have looked at and how we have analyzed it. We have made a good faith effort to try to analyze the evidence. But so far, none of the evidence that we have seen is consistent with the story that the cause of the crisis in these lines is collusion.

Mr. MARTINEZ. Thank you, Mr. Chairman.

Chairman **LaFalce**. Mr. Oliver, I wonder if you would have a somewhat different perspective on that issue raised by Mr. Martinez.

Mr. **Oliver**. I am not sure I have, largely because the FTC has not studied the insurance business. As you know, we are proscribed from studying it. So, I don't really have any perspective on the particular matters that you talk about on its structure.

I have some general thoughts on the structure of the industry, but they do not relate to any particular concerns you may have had in California.

Chairman **LaFalce**. Let me ask a few questions.

Now, Mr. Oliver, you strongly favor repeal, at least of the antitrust exemption of McCarran-Ferguson, if not the entirety of McCarran-Ferguson. Correct?

Mr. **Oliver**. Yes; I think the distinction there is it is very important to some people. It is less important to me if it was thought good to repeal only the exemption from the antitrust law but maintain the part that deals with taxing and regulating. I think it is unnecessary to retain that aspect.

Chairman **LaFalce**. Unnecessary in the sense that it is a redundancy?

Mr. **Oliver**. I think so. I think it is perfectly clear the States have the right to tax and regulate, but if some people feel there is genuine doubt, I don't think it would harm matters to keep that part in.

Chairman **LaFalce**. All right, fine.

Mr. **Oliver**. Nevertheless, I am in favor of repealing the whole thing.

Chairman **LaFalce**. Yes; you favor repealing the entirety of McCarran-Ferguson, and if not, in order to accommodate others, you would certainly then, as a compromise, favor repealing the antitrust exemption.

Mr. **Oliver**. Exactly.

Chairman **LaFalce**. And you feel that to repeal the entirety of McCarran-Ferguson would do no harm because the legislation that says the States shall have the power to regulate is superfluous legislation in the absence of congressional action to the contrary. And if there were congressional action to the contrary, even if McCarran-Ferguson remained on the books, that congressional action to the contrary would supersede McCarran-Ferguson. Correct?

Mr. **Oliver**. Yes; I think that is correct.

Chairman **LaFalce**. I follow your logical thinking, but I also understand the politics of the situation, too. So, as we proceed on this, we will have to take both logic and politics into consideration.

Mr. **Oliver**. Yes; always.

Chairman **LaFalce**. Let me just ask a few questions now.

You have said that it is not cynical to suspect that at least some insurers have taken advantage of McCarran-Ferguson immunity to harm consumers. And then you said, but I'll not discuss that. Well, please do discuss that. I mean, what makes you suspect that at least some insurers have taken advantage of McCarran-Ferguson to the detriment of the consumer?

Mr. **Oliver**. Well, simply, that we have the antitrust laws because we think they are necessary. We think that somewhere in each business community, in each industry, there will be some people who will behave in ways that the antitrust laws are designed to prohibit. And if we assume that there is going to be that anticompetitive behavior in one industry, and therefore that would justify having antitrust laws at all, there is no reason in my judgment to suppose that that kind of anticompetitive activity would not be engaged in by some people in the insurance industry.

Chairman LaFalce. I would suppose that the larger the industry, the greater likelihood that at least some companies and individuals within that industry would be likely to violate antitrust conduct. Correct?

Mr. Oliver. I think that is probably true depending always, of course, on the structure of the industry.

Chairman LaFalce. Surely; and the size of the industry. As I understand it, the insurance industry contributes approximately 12 percent to our gross national product. Now, you may or may not be able to verify or refute that. But can you think of any other industry quite as large as the insurance industry as a percentage of the total gross national product of the United States of America?

Mr. Oliver. I'll rely on your figures.

Mr. McDade. Home builders, electronic association.

Chairman LaFalce. I do not know if they contribute more than 12 percent. They may or they may not.

Mr. McDade. I think the home builders are about 15 percent, and the electronics—the only reason I would know about the electronics is because I was at their convention not long ago, and they claim to be around 18 percent.

Chairman LaFalce. OK. Well, we have some pretty big players there. Twelve percent, if not the biggest, is certainly one of the biggest.

Mr. McDade. They are enormous.

Chairman LaFalce. They are enormous. And to make them exempt to me is illogical.

Of course, this exemption is not triggered automatically. It has to involve, does it not, the "business of insurance"?

Mr. Oliver. It is an exemption for the business of insurance.

Chairman LaFalce. An exemption for the business of insurance.

Mr. Oliver. Yes.

Chairman LaFalce. As opposed to the business of insurers. But I am not sure what the difference is between business of insurance——

Mr. Oliver. Well, if they were engaging in some other kind of business, running a business on the side, having a subsidiary business, that would presumably not be exempt.

Chairman LaFalce. And only if that business of insurance is "regulated by State law."

The problem is, Mr. Oliver, you have stated that even a cameo appearance by the State suffices for the purpose of fulfilling the requirements of the definition "regulation"—the "State regulation." Do you have any judgment as to how many States give little more than a cameo appearance?

Mr. Oliver. I do not, and I don't know if the FTC has collected that kind of information since 1980. And if we had it before then, it may well have changed since 1980. So, I can't answer that question.

Chairman LaFalce. It would be interesting to look at some GAO studies that deal with the efficacy of State——

Mr. Oliver. I am not allowed to look at them.

Chairman LaFalce. You wouldn't even be allowed under present law to look at GAO studies. I do want to get into that because that intrigues me.

But suppose in our treatment of McCarran-Ferguson we, first, repeal the antitrust exemption, but second, do not repeal the rest of McCarran-Ferguson, so that we make it clear that the insurance industry is still, in the absence of explicit Federal regulation to the contrary (explicit as opposed to implicit—and there is an important distinction which I understand) controlled by State taxation and State regulation. But to avoid Supreme Court interpretations which say that even a cameo appearance suffices for State regulation, that we either define what we mean by State regulation or establish some standards for adequacy of State regulation. What would you think of that?

Mr. Oliver. Well, I guess I would be reluctant to have legislation that tried to define what adequate State regulation was because you get one group of legislators second guessing another. I think I prefer to leave it just the way the State action doctrine is now. We have a State action doctrine for the other aspects of antitrust conduct. And I think I would at least leave it until we discover that it wasn't working.

The State action doctrine works in other areas, and before we change that and have Congress define what constitutes adequate State action, I think I would rely on the system we have now to see if it produced adequate——

Chairman LaFalce. You were criticizing the——

Mr. Oliver. That's, I think, because of the existence of McCarran-Ferguson. I think if you repealed McCarran-Ferguson or the antitrust exemption, that aspect, the court interpretations that——

Chairman LaFalce. Would fall by the wayside.

Mr. Oliver. I think so, yes.

Chairman LaFalce. All right, fine.

Now, one of the reasons that you have difficulty in speaking enthusiastically—I should not put it like that. One of the reasons you don't feel totally comfortable is that you fear the possibility of undue regulation coming about under the guise of repeal of the antitrust exemption. I appreciate that and understand that. I serve on the Banking Committee, and, basically, I have favored deregulation. I have worked with both the Carter and Reagan administrations to help effectuate that.

Of course, deregulation does not mean no regulations. It means better regulations. Nobody ever talked about not regulating the banking industry. They talked about better regulation, and then that became known as deregulation.

And with respect to the insurance industry, you are not opposed to regulation of the insurance industry. You believe there must be some appropriate regulation of the insurance industry, do you not, Mr. Oliver?

Mr. Oliver. Well, I think that that regulation could take place on the State level.

Chairman LAFALCE. That is not my question. Wherever it takes place, you must have regulation of an industry of that size, must you not?

Mr. OLIVER. There is probably an appropriate level of regulation.

Chairman LAFALCE. So, the question then is, (a) what is appropriate, and then (b) who should be providing that appropriate regulation?

Mr. OLIVER. That is right.

Chairman LAFALCE. Why should the airline industry be regulated on the Federal level? Why should the banking industry, in effect, have dual regulation? How could one State regulate the banking industry if we did not have an FDIC, if we did not have the Federal Reserve Board? And these banks operate in every State in the Union. They operate internationally.

Assuming that the regulation was appropriate, as opposed to inappropriate, moderate as opposed to excessive, what would be so wrong with Federal regulation? And understand that I understand the distinction between McCarran-Ferguson and Federal regulation, but this is just an academic question.

Mr. OLIVER. Well, there would be two questions. One is whether it would be appropriate at the Federal level, and the second question would be what is appropriate.

Chairman LAFALCE. I understand, assuming that it would be appropriate, whoever the regulator was. Why not the Federal level rather than the State level when you're dealing with an industry that deals in interstate commerce every second of every day?

Mr. OLIVER. Well, I guess I am not convinced—and again, I have to say that I do not study insurance, so I really cannot answer your question. But I would not be convinced that a regulation at the State level could not solve any problems that might arise. I mean, before you talk about regulation, you have to talk about the problem. And only after you have found a problem, do you get around to deciding whether or not you need to regulate it, assuming the market cannot solve the problem. Then you decide whether you want to regulate it at the State level or the Federal level. But it is hard to talk about regulation in the abstract.

Chairman LAFALCE. Well, we are not going to be providing any bill for Federal regulation. So, let's get off of that.

Mr. OLIVER. If I may make one comment. I have seen some attempts—and I hope they will not get anywhere—for the Federal Government to regulate the dispensing of prescription drugs by doctors. I testified last week on that matter. That strikes me as being a State matter if there ever was one, and yet we spent all morning discussing whether the Federal Government should regulate the dispensing of prescription drugs by physicians. That gives me cause to worry.

Chairman LAFALCE. OK, OK. I am not going to get into the prescription drug issue.

Mr. OLIVER. I do not blame you.

Chairman LAFALCE. Since we are talking about the appropriateness of Federal action, the Reagan administration has argued for Federal changes in tort law. Would your rationale that the States should regulate, be equally applicable there, and therefore would you find yourself in opposition to the position of the Reagan administration calling for Federal changes in the tort law?

Mr. OLIVER. I would like to answer the question. Unfortunately, I really have not studied tort law, and I cannot answer the question.

Chairman LAFALCE. You said that you had not studied insurance and yet you answered my question as to the propriety of Federal as opposed to State regulation of insurance. And so, surely you would not want to refuse answering the question simply because it would put you at odds with the Reagan administration.

Mr. OLIVER. Oh, I would. [Laughter.]

Chairman LAFALCE. So you want to cop out, because you do not want the discomfort of opposing the Reagan administration. Let the record indicate that the chairman concludes that he really does then oppose the Reagan administration's position on this issue.

Mr. OLIVER. Let the record also say that silence does not deem consent.

Chairman LAFALCE. In most instances.

Mr. MCDADE. Also, he did say that he was not an expert in insurance matters, and therefore did not want to state a position.

Chairman LAFALCE. He did state a position. That is the point with respect to the propriety of either State or Federal regulation with respect to the insurance industry.

Mr. MCDADE. On a theoretical basis.

Chairman LAFALCE. If he does it in one instance, he better do it in the other.

Mr. MCDADE. It seemed to me, Mr. Chairman, that he was doing it on a theoretical basis. And the theoretical basis of where you regulate is a subject that all of us are very interested in and have different viewpoints on.

Chairman LAFALCE. He could have done it on a theoretical basis for tort law, too, then. Then let us go on to something that is not too theoretical.

Why did the Congress, in your judgment, act to proscribe the Federal Trade Commission from even studying the practices of the insurance industry in 1980? What led up to that, what was the FTC up to that either the Congress or the insurance industry, or the Congress at the behest of the insurance industry, said that you had better not look into it any further?

Mr. OLIVER. As a matter of fact, I do not know the answer to that. I was not here then. I was not in Washington then, and I was not following the issue.

Chairman LAFALCE. If you want to repeal that prohibition, it would seem to me that it would be worth your time to investigate what led up to the prohibition.

Mr. OLIVER. No; I think that we should have the right to study it anyway.

Chairman LAFALCE. I agree with you that you should have the right to study it anyway.

Mr. OLIVER. As a question of right.

Chairman LAFALCE. But if you are going to be more thorough and more effective in your argument to advocate to the Congress for repeal of the prohibition, a little bit of knowledge as to why the prohibition was created in the first place would be helpful to you, Mr. Oliver.

Mr. OLIVER. I think that I should be able to study that. I am going to study that.

Chairman LAFALCE. OK, good, you go study that.

Let me ask Mr. McDade, Mr. Rhodes, or Ms. Meyers if they have questions.

Mr. MCDADE. Could I just follow up on that?

Chairman LAFALCE. Yes.

Mr. MCDADE. We were talking with the GAO yesterday. They have been attempting to do work in medical liability, and so forth. And we were talking about the question of whether or not, given a certain agreed upon series of statements, for example, there is a liability crisis in the country, is there something occurring that we need to know about based on profitability and claims, et cetera, et cetera, and why is John Q. finding himself either not able to be insured or not able to be insured at a reasonable rate.

And they described it as a problem of lack of manpower, lack of expertise, except in some of these areas where they had been specifically required, for example, to look at medical tort law and they looked at that, and they felt comfortable there.

But the other areas that would involve the dimensions of the problem were such that they thought that it would take them, given additional resources which they claim they would need, three to five years to be able to report back as our accountants on how they saw this very complicated situation, and what recommendations that they might make to us to make sure that we were making good public policy and protecting the public interest.

Recognizing that you have not had any opportunity, do you have any kind of a feel for what would happen if you did in fact at the FTC have the right to look at the problem to make recommendations as a creature of the Congress to the Congress on the issue? Do you have any idea of the time, do you have the resources?

Mr. OLIVER. I would think, and I am just guessing now, and I really would have to consult the director of the Bureau of Economics to get a better answer for you, but I would suppose that it would take us a year to do a study that would be comprehensive enough to provide the kind of information that would be useful.

I doubt that it would be the whole industry, but it would be selected aspects in order to give the Congress vignettes of the shape of the industry and the shape of the competition in the industry. To some extent, it would depend on how much work that you would do.

Mr. MCDADE. Could I suggest that you be given the opportunity to embellish your remarks in the record, so that you have an opportunity to look at it. Because I was really surprised at the length of time that GAO thought that it would take them. And I would like to see if we could establish in the record what would be based on what is really, I recognize, not hard facts, because you have not really been in that problem, but the best advice that you can give the committee for purposes of guidance.

Mr. OLIVER. Yes, sir.

Mr. MCDADE. Thank you, Mr. Chairman.

Chairman LAFALCE. Mr. Rhodes.

Mr. RHODES. I have, I guess, Mr. Chairman, an observation more than a question. Because the direction that these hearings are going, maybe I cannot see the direction that it is going, although I have found them to be very interesting, and I appreciate that you are holding them. I have learned a lot, and I have had some of my preexisting knowledge expanded, if you will.

But it seems that we commenced with an assumption with which I agree, that there is a liability insurance crisis. We commenced with an assumption from the insurance industry that the way to solve that crisis is to reform the tort system, an assumption with which I do not agree, and which I gather that you have some serious doubts about.

We then began to question the insurance industry as to empirical data which would lead us to the point where we can conclude (a) whether or not there is in fact a crisis; and (b) if there is a crisis, whether it was caused by the court system or by their own business practices.

And now, we are going in the direction of is there data available or can it be gathered which would lead us to the conclusion that the McCarran-Ferguson Act should be, either partially, or totally, repealed, and that the Federal Government, either partially, or totally, regulate the industry. It seems to me to be kind of a quantum leap from that we should be reforming the tort system.

So, as I said earlier, I have enjoyed and appreciate these hearings, but I am rather unsure as to just exactly where it is that we are trying to go and how we intend to get there. That is the observation that I wanted to make.

Chairman LaFalce. Well, let me just comment since you really did not ask a question of the witnesses. I think that you and I are in fairly fundamental agreement in our analysis. Where we should go is not decided, or where I shall go is not really decided.

But a good many individuals have called for a good many different actions. The White House Conference on Small Business, for example, called for a multiplicity of actions including consideration of the repeal or modification of McCarran-Ferguson, and including changes in tort laws, and so forth.

I tentatively would say that I think there is enough evidence to persuade me that we should repeal the antitrust exemption of McCarran-Ferguson, and perhaps make clear at the same time that we are not affecting the existing pattern of State regulation or State taxation of the insurance industry. Also, we surely should repeal the prohibition against the FTC even studying the practices of the insurance industry.

I also think that we need much better data. And I do not know how best to get that data. Whether the Federal Government should collect it itself, or whether the Federal Government should try to articulate certain minimum standards that they need, and then try to work with either ISO or the National Association of Insurance Commissioners to have them collect that data and make it available.

So there are different approaches that can be taken, Mr. Rhodes, and I look forward to discussing the different options with you. Personally, I see nothing wrong with a Federal uniform product liability law, but there are individuals who are opposed to that conceptually. And there are some individuals who want it, but they want it in order to bring about draconian changes in our law.

Now I do not want to do that. I believe, though, that uniformity and predictability is highly desirable, as we have uniformity and predictability under our uniform commercial code, which was adopted by the 50 States with almost universal uniformity. But I do not think that will ever happen with product liability.

But I also think that it would have a de minimis effect on the liability insurance crisis. It is also possible that the repeal of the antitrust exemption in McCarran-Ferguson would have little effect on the liability insurance crisis, and I am cognizant of that.

But it also might help prevent whatever collusive activities do exist or may exist within the insurance industry that we do not know about right now, because they have never been able to be tested in the courts, as Mr. Oliver has pointed out.

I also suspect that we do need much better regulation of the insurance industry, but it would be virtually impossible to pursue that on a Federal level. And since pursuing it on a Federal level would probably deter successful pursuit of other objectives that I am not going into, you and I would differ philosophically on that, but we would not differ practically on that.

But I think that more effective regulation whether on the State or on the Federal level could help ameliorate some of these cyclical volatile disruptions within the insurance market. So, enough said there. Mr. Mazzoli.

Mr. MAZZOLI. Thank you, Mr. Chairman. I came in late, and I might be asking questions that have already been asked, so I apologize.

But is it the position of the Federal Trade Commission, Mr. Oliver, that you should not have the opportunity to look into insurance, that you prefer to be where you are today without that authority?

Mr. OLIVER. No; we would like the authority to investigate the business of insurance.

Mr. MAZZOLI. And if you had that authority, do you think that you could get better data for this committee and for the world to study?

Mr. OLIVER. Well, I think we could, yes.

Mr. MAZZOLI. Because the chairman, in what I think was a very excellent opening statement which I have just read, said that you have this 800- or 900-percent differential between the methodology about how many suits are filed and apparently the actuality.

Do you think that you would, by having that authority to look into it, be able to help and glean this data, or would it still be prohibited from your attention because of any antitrust protections?

Mr. OLIVER. No; if we were given the authority to study, we would be able to collect, precisely, that kind of data, but we have to have the authority given to us explicitly.

Mr. MAZZOLI. Mr. Rule, I did read part of your statement, and you indicate that you apparently are for retaining the State authority over taxation and regulation, but that you would not now advocate the institution of antitrust exemption for insurance. And you are a little hesitant about advocating its abolition because of ripple effects and problems, but you do sense that that could be done away with if it is done carefully.

Is that essentially correct?

Mr. RULE. That is essentially correct, yes.

Mr. MAZZOLI. And if it is done away with, in what fashion would the Justice Department and the Antitrust Division be able to engage in this issue?

Mr. RULE. Well, we are not disabled in the same way that the FTC is from studying the industry. And indeed over time, there have been some investigations of the insurance industry that have not involved the business of insurance, or have involved coercion, boycotts, the sort of conduct that is subject to the antitrust laws. But we are not disabled as the FTC is.

Mr. MAZZOLI. Well, you make a fairly flat conclusion on the first page of your statement, Mr. Rule, that you do not sense that the antitrust exemption has led to the crisis in liability coverage.

I would just ask you respectfully how do you reach that conclusion?

Mr. RULE. Well, there are several different ways. One is through some of the data about profitability, but I will get off that because I know that there is a great deal of dispute about that. But just in terms of correlations, the McCarran-Ferguson Act has been in existence for over 40 years. These lines of insurance have existed for at least that long and perhaps even longer.

It would be very surprising if it took 40 years for the industry to figure out how to collude, and then they colluded only on these particular lines of insurance. And not only that but instead of just raising the price, they decided not to sell the stuff at all.

So just purely on the basis of timing, on the selectivity of the crisis, and the way that the crisis has manifested itself, it does not seem terribly persuasive that collusion is an explanation.

There is also the structure of the industry, which is not the sort of structure that one would expect to find or to associate with successful collusion in an industry. So all of those things lead us to believe that collusion cannot be an ascribed responsibility.

Mr. MAZZOLI. We have to go to a vote, and I am sure that the chairman is going to recess the hearing.

But it seems to me that if you can combine to deal with rates, and the structure of the charges, and the exposure, and the risk and liability, if you can do that, and apparently the insurance industry can do it, is it not almost inevitable to believe that they can in times of certain market conditions cooperate together, if not collude? At least cooperate together in maximizing the ability to raise money through premiums and minimize their risk through reducing coverage, just by the very nature of their being able to set these things in a kind of an across-the-board fashion?

Mr. RULE. Well, they certainly are able, and it still makes sense to pool experience data to come up with actuarially sound data. But if one tried to then load on top of that, some additional profits, another company can come along using that same data and say, well, I am going to undercut him, because I am willing to live with half of the profit that he is, and pretty soon somebody comes in and says I will live with half of the profit that he does.

So it is true that you are going to have some common cooperative activities in terms of collecting this data, and in terms of making it actuarially sound, and doing all of the sort of calculations that have to be done.

But beyond that, the real question is whether or not they are loading it up with profits that they just simply stick in their pockets, and are not designed to cover these future risks. And if the industry is very competitive and if there are a lot of people who are able to come in and compete away these excess profits, it is very difficult for a few members of the group to get together to try to raise those prices.

Mr. MAZZOLI. I thank you very much. Thank you, Mr. Chairman.

Chairman LAFALCE. The committee will be in recess for 10 minutes, so that we can make this vote, and we will then return and resume.

[Recess.]

Chairman LAFALCE. Mr. Oliver, you gave some praise to the action that the Senate took about a week or two ago or thereabouts, which gave you specific authority to conduct a certain type of studies. But, actually, having the Senate give you authority is something that the Commerce Committees themselves could have done if it were their desire.

Was that not really a very minor step, and would it not be far, far preferable to actually repeal the prohibition, so that you could investigate or study those things that you desire to study, as opposed to only being able to study now, those issues permitted by the language of the Senate?

Mr. OLIVER. I believe it would be, and then we could craft a study that we thought would be most useful given the time and the resources that we put into it. So I think that it would make more sense to let us determine what the best way to study the industry was.

Chairman LAFALCE. One possible compromise might be to do both. To (a) repeal, so that you could do what you wanted to do; but (b) to specifically mandate that you conduct the following types of studies.

Would you have any objections to that?

Mr. OLIVER. I think that would be good, because that would allow us presumably in the course of doing the mandated studies to look elsewhere if it seemed appropriate, whereas now I suspect that we would have to be careful not to investigate the wrong area.

Chairman LAFALCE. All right.

Suppose that I were to introduce a bill that included the language of the Senate, but also included a repeal of the prohibition, would you be supportive of that?

Mr. OLIVER. I think that it would be a good move.

Chairman LAFALCE. All right, fine. I would also like you to supply for the record, a statement as to why the FTC believes it lost its authority in 1980, that is, what was the FTC doing in that era?

Mr. OLIVER. I am told that it resulted from a study that the Commission did on how good an investment life insurance was, the staff study. I understand that it was a staff study that concluded that buying life insurance was not a good investment.

Chairman LAFALCE. The insurance industry did not like that, and therefore they got enough Members of Congress to support their position.

Mr. OLIVER. I think that is correct.

Chairman LaFalce. And all of a sudden, the messenger was shot rather than the message, is that right?

Mr. Oliver. That is my understanding.

Chairman LaFalce. All right. I would appreciate it if you could embellish on that in writing.

Mr. Oliver. I would be delighted to.

[The information follows:]

FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

THE CHAIRMAN

May 15, 1987

The Honorable John J. LaFalce
Chairman
Committee on Small Business
United States House of Representatives
Washington, D.C. 20515

The Honorable Joseph M. McDade
Ranking Minority Member
Committee on Small Business
United States House of Representatives
Washington, D.C. 20515

Dear Messrs. LaFalce and McDade:

This letter is in response to your requests for further information on two matters raised in the course of my testimony before the Small Business Committee on April 29, 1987.

Chairman LaFalce has requested information on the circumstances that led to enactment of the 1980 amendment to the Federal Trade Commission Act that prohibits the Commission from studying the business of insurance. As you know, the FTC Improvements Act of 1980, P.L. 96-252, amended Section 6(h) of the FTC Act, 15 U.S.C. § 46(h), to include a paragraph restricting the Commission's ability to investigate or prepare reports relating to the business of insurance. This amendment, which was sponsored by then Chairman Cannon of the Senate Commerce Committee, was intended to prevent the Commission from conducting factfinding investigations, to "clarify" the jurisdictional limits imposed on the Commission by the McCarran-Ferguson Act, and to incorporate some of those limits into the FTC Act. S. Rep. No. 500, 96th Cong., 1st Sess. 13-15 (1979) ("Senate Report").

Acting on the belief that the McCarran-Ferguson Act precluded only enforcement actions under Sections 5 and 18 of the FTC Act, but not factfinding investigations or the issuance of public reports under Section 6, the Commission, in the late 1970's, undertook a series of studies of the insurance industry. One such study, conducted at the request of the Senate Antitrust and Monopoly Subcommittee, revealed the low rate of return of whole life insurance policies. Another highly publicized study analyzed state-regulated automobile insurance rating classification systems. This study was intended to lead to a model for evaluating the fairness and accuracy of those systems.

The Senate Report took issue with the Commission's interpretation of the scope of the McCarran-Ferguson exemption. According to the Senate Report, the Commission had been divested of not only enforcement authority but also the authority to conduct factfinding investigations. Senate Report at 13-15. The Senate Report therefore concluded that the Commission had acted outside the scope of its jurisdiction in conducting insurance studies. *Id*. In addition, the Senate Report expressed concern that several of the matters then under FTC investigation were also being investigated by state insurance departments. *Id*.

Turning to the second request, Mr. McDade inquired into the length of time that would be necessary for the Commission to conduct a study of liability insurance. In the course of my testimony on April 29, I tentatively estimated that the Bureau of Economics could complete some study of the liability insurance industry within a year. I am now able to confirm that an overview study of that industry could be conducted within one year, provided that the study were based on publicly available information. A more in-depth study, particularly one involving use of the Commission's data collection authority under Section 6(b) of the FTC Act, would require at least eighteen months.

I trust that this information is responsive to your requests. I will be happy to provide any additional information that may be necessary for your purposes.

Sincerely,

Daniel Oliver
Chairman

Chairman LaFalce. All right, good. I wish that Mr. Rhodes were here too, because I want to tell him that the National Association of State Attorneys General also advocates repeal of the antitrust exemption of McCarran, so you have some State officials who support it.

Are there not, Mr. Rule, State antitrust laws which are applicable to the insurance industry?

Mr. Rule. It would depend on, as I understand it, the particular State. Some State laws, State antitrust laws, may apply to the insurance industry. But I also understand that there may be situations where, in effect, the State regulatory scheme is structured in such a way as to leave it to the State insurance commission rather than the antitrust laws to regulate prices, and collusion, and that sort of thing in a particular State, but it would vary from State to State.

Chairman LaFalce. Do we know of any study regarding State schemes for dealing with activity that would be violative of antitrust on the Federal level?

Mr. Rule. I know of none.

Chairman LaFalce. I mean if proscribed by State law, do you know of any?

Mr. Rule. I know of none.

Chairman LaFalce. If you know of none, I suspect there is none. Now you have said, Mr. Rule, that you do not have any evidence or that you have not seen any evidence that collusion has produced this recent crisis, or that there is collusion in the insurance industry, and that may or may not be the case, and I do not know.

But what was the circumstantial evidence, and it was circumstantial according to you, what was the nature of that circumstantial evidence that led you to that conclusion?

Mr. Rule. The circumstantial evidence was severalfold, and this was based on the analysis that our economists had done, and as I indicated was in this recent publication that came out, the study. But one was the circumstantial evidence of the profits in the relevant period and the profits in the particular lines of insurance that we are talking about that did not look to be super normal.

Now it is difficult to calculate profit rates that are economically sound, so you cannot rest a whole lot of your conclusion on that. But the profits did not seem to be abnormal in those particular lines.

Second, where you have a price fixing cartel or someone is colluding, essentially they are trying to get more money, and they are trying to sell a particular service or product at a higher price.

And as we know, part of the crisis is an availability crisis. And one would not expect collusion to result in a refusal to make available insurance. One would simply see it made available at a higher price.

Chairman LaFalce. Was it not a dual problem of availability and affordability with a much larger emphasis on affordability than availability?

Mr. Rule. It certainly is true that part of it is affordability. But all I am saying is that one would not expect to see that there would be an availability problem that would coincide with a situation where you had collusion as an explanation.

Chairman LaFalce. Well, I think that availability came about primarily because of affordability. And so, if it became so unaffordable that it was unavailable, it then became referred to as a problem of unavailability or unaffordability. But because of the unavailability, it seemed to me, there was no mass cessation of writing of certain lines, but making those lines unaffordable.

Mr. Rule. I would defer to you on that.

Chairman LaFalce. If that is true then, what does that do to your argument?

Mr. Rule. Well, it simply says that one cannot say that the lack of availability is a reason to believe that collusion is the explanation.

Chairman LaFalce. Then that leaves you with virtually no circumstantial evidence that you have collusion.

Mr. Rule. I only mentioned two, but let me mention the others. I am probably going in ascending order.

Chairman LaFalce. Ascending?

Mr. Rule. Ascending order. The next that seems to be the case, and this at least seems to have a great deal of appeal, is that it is very hard to understand the timing of this. If this were due to collusion, one wonders why it was these particular lines, and why it took place at this particular time. The McCarran-Ferguson Act has been in existence——

Chairman LaFalce. Why do you say these particular lines? Is it not one line, basically, "other liability" insurance, for which there is almost no breakdown of discrete data of the more than 1,100 sublines within that one line?

Mr. Rule. Well, that is a data question. But as far as I know, it is not true that in every one, uniformly across the board, of the other liability lines of insurance that there is a crisis.

Chairman LaFalce. It is "other liability." It is not those lines for which there is discrete data, but it is that line for which there is no discrete data.

Mr. Rule. But that is a data issue. That is an issue of how one can get the data, but that is not an issue of whether or not—as far as I know, no one has said——

Chairman LaFalce. Is it not easier to have collusion when other people cannot get data, than it is to have collusion when other people can get the data?

Mr. Rule. Actually, there is an argument. The argument generally goes that it is easier to collude when all of the members of the industry know what everybody else is doing. Because if you do not, it is very difficult to trust you.

Chairman LaFalce. Well, all of the other members of the industry know, but nobody else knows.

By definition, do not all of the members of the industry know because of the existence of ISO; now tell me a little bit about ISO, what do you know about ISO?

Mr. Rule. I really know very little about ISO.

Chairman LaFalce. Mr. Rule, how can you come before this committee as head of the Antitrust Division of the Justice Department and talk about McCarran-Ferguson and talk about a lack of collusion, if you do not know what ISO is?

Mr. Rule. I do not know very much about ISO.

Chairman **LaFalce**. What do you know about it?

Mr. **Rule**. As I understand it, it is an industry group. And the reason that I came here, at the invitation of the committee, was to try to explain——

Chairman **LaFalce**. Well, I understand, but we expect from certain individuals in certain positions a certain degree of knowledge when they have spoken out on the issue.

And ISO, what does that stand for?

Mr. **Rule**. I honestly do not know.

Chairman **LaFalce**. Insurance Services Office.

Who owns ISO?

Mr. **Rule**. I do not know.

Chairman **LaFalce**. Virtually every major insurer in America.

Who is the chief data collection entity in the United States of America, the repository of virtually all of the knowledge with respect to the insurance industry?

Mr. **Rule**. I assume from your questions that it is ISO.

Chairman **LaFalce**. Who determines what the rates should be and makes those rates available to all of the insurance companies in America that participate in ISO, which is the vast preponderance of property/casualty companies, i.e., 85 to 90 percent of them?

Mr. **Rule**. Well, as I understand the insurance industry, the way that insurance companies may calculate their actuarial tables on which their premiums are based——

Chairman **LaFalce**. Who makes the suggested rates?

Mr. **Rule**. In some cases, as I understand it, certain companies will internally generate that information, if they are large enough. There are other areas where that may not be.

Chairman **LaFalce**. Would you dispute the fact that ISO may make the suggested rates 90 percent of the time?

Mr. **Rule**. They may make suggested rates, but I am not sure whether or not I could say that——

Chairman **LaFalce**. That is my question, suggested rates. I am not saying who determines what the rates shall be for a company, but who determines what the suggested rates should be?

Mr. **Rule** [continuing]. Well, ISO may provide suggested rates, but whether or not they are the ones that are used——

Chairman **LaFalce**. Is that not by definition collusion, collusion which is permitted by law?

Mr. **Rule**. No; it is not collusion by definition. There are a lot of cooperative activities that companies can engage in and that companies engage in all of the time. What is collusion is an agreement solely on price that has no, what is known in the law as, integrative efficiency.

Chairman **LaFalce**. All right.

Mr. **Rule**. The collection of data, in effect, the application of actuarial or at least sound principles to that data to develop trends is, I think, a classic example.

Chairman **LaFalce**. Collection of data is one thing, but suggestion of rates is something else, is it not?

Mr. **Rule**. Well, if what you are trying to do is understand what the projected losses are going to be, that is very important to an insurance industry, because that is a component of cost.

Chairman **LaFalce**. Well, I am talking about suggesting rates.

Is there not a big difference between (a) gathering facts; (b) projecting losses; and (c) suggesting rates?

Mr. RULE. If you mean also, the loading factors for expenses, and overhead and that sort of thing, there is a difference. But if you are talking about the trending of the rates and the premiums that have to be charged to cover those expected occurrences, that is simply a projection of what one thinks is going to happen in the future, and that is the nature of insurance, and that is by no means collusion.

What collusion is, is an agreement on the prices that are going to be charged. And the fact that a rate is suggested or a rate is discussed does not mean that there is collusion going on in an industry.

Chairman LAFALCE. All right.

Do we have any knowledge as to the practices of the industry where one company might set a rate and the other companies might follow suit? Do we have any knowledge of that?

Mr. RULE. Well, in many cases, it is the regulatory scheme that results in a setting of rates, because you have to file your rates in some States, and they have to be public before you can deviate from those.

States are moving more and more toward a filing used where you can basically come up with the rate upon filing or perhaps even use it in filing.

Chairman LAFALCE. On filing rates.

Are you aware that yesterday ISO testified that they are (a) the statistical agents for the States in the collection of insurance data and (b) rate-advisory organization for insurers? So, they are owned by the insurance companies. And even though the insurance companies own them, as they do, the States then say, despite the fact that you are owned by the insurance companies, we make you our statistical agents, and you, therefore, collect the data for us.

And then ISO turns around and acts on behalf of the companies in 90 percent of the cases, according to their testimony, in filing not the suggested rates that ISO recommended to the companies, but in filing the rates being sought by the individual companies.

So, in 90 percent of the cases when an insurance company files with a State, if I am correct in my recollection of yesterday's testimony, they have ISO file their rate with the insurance departments.

Now to discuss the word collusive. Is not this ISO activity a certain type of concerted activity that someone in the Antitrust Division, as head of the Antitrust Division, might want to at least look at?

Mr. RULE. Well, there may be some circumstances where we would.

Chairman LAFALCE. And you are not proscribed from looking at it, as Mr. Oliver is proscribed. I suspect that Mr. Oliver might want to look at that as well, if he were not prohibited from doing so. But you are not prohibited from doing so.

Mr. RULE. That is right.

Chairman LAFALCE. And ISO also makes available to each of their members who own them, the premium rates charged by other insurance companies, especially with regard to personal lines of insurance.

Does that disturb you?

Mr. RULE. There are certain aspects of State regulation that may be of concern.

Chairman LAFALCE. They are able to do this, are they not, because of the exemption from the antitrust laws?

Mr. RULE. No; they would be able to do it even in the absence of the McCarran-Ferguson Act if it were protected by the State action doctrine, which very well would probably apply in many instances because of the nature of State insurance regulation.

I mean this exists in areas like intrastate trucking regulation, where the Supreme Court in the *Southern Motor Carriers* case indicated, as have a number of cases that we brought against intrastate trucking, that collective rate activity was protected by State regulation.

Chairman LAFALCE. Forget about what they would be able to do.

Does it not disturb you; in other words, do not the facts that I have just recited, assuming their validity, and I base their validity upon my best recollection of yesterday's testimony and other testimony that I have received, does that not disturb you a little? Do you not think that it is something that should be looked at?

Mr. RULE. I think that without knowing and breaking down all of the parts of what is going on in terms of collective activity, I think that it is dangerous to presume that there is necessarily something adverse going on.

Chairman LAFALCE. Oh, I think that it would be dangerous to presume that, but do you not think that you should be disturbed enough that you would want to investigate the question?

Mr. RULE. Well, what we have said in respect to——

Chairman LAFALCE. Are you not, as Mr. Oliver is, cynical enough to suspect the possibility?

Mr. RULE. Well, there certainly is some collusion, or there may be some collusion going on in certain particular areas, and there may be some isolated cases of collusion going on, and I do not dispute that. And there have been cases in the past where the insurance companies have been found to violate the antitrust laws by engaging in coercion and boycotts, which are not protected by the McCarran-Ferguson Act.

But I am simply making the point that it is very difficult to argue, based on the structure of the industry, that the affordability and the availability crisis is due to the McCarran-Ferguson Act. That is the simple point, not whether collusion is ever occurring.

Chairman LAFALCE. All right. That is one point. And let us accept that point for the sake of argument. But the points that I have been making are separate from that. It seems to me that we should be concerned if one entity is not just collecting data, but suggesting rates. I think that you do need a central repository for data, because I think that you do have to have a nationwide body of knowledge, at least with respect to data, if you are going to establish appropriate rates.

But it concerns me that this same entity is suggesting rates and that this same entity is the statistical agent for virtually all of the

States, and that this same entity is the filing agent for the insurance companies for rates.

And when I say that it disturbs me, I am not charging that there is something wrong. And I am not cynical, but I am suspicious. It is a healthy suspicion. And it would seem to me that anyone in the Antitrust Division should have that type of healthy suspicion too, and want to look at it.

Let me ask something else now. You have said that the possible difficulties with repealing the antitrust exemption of McCarran-Ferguson could be dealt with if the law were adequately drafted, appropriately drafted to deal with those.

Mr. RULE. There is certainly reason to believe that that can be done.

Chairman LAFALCE. I am now, as chairman of the Small Business Committee, officially asking you to assist me in drafting such a law. That would not mean that the administration is advocating it. I understand what the Justice Department's position is. But I am seeking your legal assistance in drafting such a law that would prevent the downside risk.

Mr. RULE. We will certainly try to cooperate with the committee to do that.

Chairman LAFALCE. All right. Thank you.

Oh, I am sorry. Mr. Mazzoli.

Mr. MAZZOLI. Thank you, Mr. Chairman.

I would like, if I could, to follow up on a little something that the chairman touched on, Mr. Rule. I have never heard of this ISO, but I gather it does collect data nationwide on risks and experience and actuarial material.

And I think it was sort of accepted here that the data ought to be collected on a national basis. I do know that some carriers write on a local or regional basis. And some panelists who have been here in earlier sessions indicated that they were being charged what they consider to be an atrocious rate when their experience has been practically impeccable. They just did not have problems. So, in effect, the rate was being written not by reason of the experience that was with the company but a broader base.

My question is why should there be national data collection if that is being fed in for basis of making rates to a company which writes on a regional basis?

Mr. RULE. Well, I suppose that it would depend on the nature of the risk that was involved. And it may be that the region and the risk exposure in a particular region is highly correlated to risks that have occurred outside that region. And therefore, one gets a more accurate prediction of what is likely to happen in the future by looking beyond the region. And there could be very good market reasons for assuming that national collection in certain circumstances is better than regional collection because experience has shown that you get a better prediction of what is likely to happen in the future by using national data.

Now, my sense would be though that if it turned out that that national data was misleading and it was not sufficiently disaggregated, and that the risk in a particular area was not necessarily highly correlated with the risks outside of that area, that insurance companies, certainly large insurance companies, or maybe a group of insurance companies, would pool their experience in that particular region and provide rates—premiums, insurance—based on that regional experience if they thought that they could develop actuarially sound data.

Mr. **Mazzoli**. Let me ask you. That is an interesting question because that, basically, gets to competition. You know, I want the business and if the other guy's price is higher than I need to make my price and make some dollars, I will put my price lower.

Mr. **Rule**. Right.

Mr. **Mazzoli**. Does that work where you have antitrust exemptions? Does the aspect of competition ever come in here where you have the companies protected, first of all, from the FTC flatly and somewhat protected from your scrutiny, if it is in what would be called the business of insurance? I mean, can that thing of competition really come in? Or conversely, wouldn't it be just as advantageous to those guys to forget to look at the local activity, charge the national rates or charge a rate based on national experience and be done with it?

Mr. **Rule**. Well, that is an interesting question, but I think it is one that in my mind, I think, has to be answered by noting that it is not simply the antitrust laws that make this economy work. What makes this economy work is the millions of decisions that are made every day in the market, people expressing what they are willing to offer at what price, and other people expressing their willingness to buy it at a certain price. And that is how the market functions.

And it is opportunities that are created out there in the market, opportunities that I think this committee is well familiar with because you are a small business committee, and small businesses are generally the ones who take advantage of those opportunities, of coming in where there is a profit opportunity, where some need is not being met at a low enough price or at a price that can still cover that individual or that company's cost and turn a little profit.

And as long as the government or some workable agreement—it is very difficult to have a workable agreement when you have as many players as you do in the insurance industry—does not prevent those companies from going in and acting in their economic self-interests to try to make a little profit by getting more business by lowering their prices, it is very difficult to stop that because that is human nature, and that is how the market works. And that is what makes this economy as strong as it is.

Mr. **Mazzoli**. Except that it seems to me you premise that activity—and I will agree. That is what has made America great and what will make it great in the future, the competition, the spirit of beating the other person to the punch, and the whole thing. But that contemplates a situation in which if you were to start playing footsy with one another, somebody else is going to come in and say you cannot play footsy any more. But here, insofar as I can see, there isn't anyone who can come in and say to these people, don't play footsy.

Mr. **Rule**. And the problem from the standpoint of someone who deals with a lot of industries other than insurance, is that what one sees when collusion is taking place is a relatively small number of players, because it is very difficult with a large number of players to coordinate activities.

Mr. MAZZOLI. I can understand that. I read that part in your paper, and I think the chairman has talked about it too. I mean, I think we are not talking about collusion in that sense where you have three or four people and they divide up the market, the blatant sort of transparent efforts to carve up a market. I think you are dealing with something very much more sophisticated. And it may, in fact, be a situation in which in the end analysis, none of these people think that they are colluding or cooperating or doing anything wrong.

But the upshot of the whole effect of having partial exemptions from antitrust, of having exemptions from FTC oversight, of having, in effect, their own little picket fenced area in which very few others can enter, that produces a situation not by design and not because the actors are trying to do something wrong, but just because they've got nobody looking over their shoulder and competition does not work.

Mr. RULE. Well, the one thing that I will say is that I am not, generally, in favor of exemptions, and I think that there is a strong burden of proof to establish one or to keep one in place. So, I do not disagree with anything you have said.

But the other side of it has to be kept in mind. And that is that a lot of small insurance companies are able to compete in this industry because they are able to act collectively to pool their experience data and to share actuaries, to develop trends and premium data that they can then go out and compete with. And if we substantially raise the cost of that sort of collective activity, we may make some small companies sufficiently inefficient as to drive them out of the business. And what you end up with is a much smaller industry in terms of the numbers of players than you have today. And it is that concern, the concern that we might chill some legitimate cooperative activities, activities that lower the cost of providing insurance by small companies, that we think we need to draft around.

Mr. MAZZOLI. Sure. I think that is laudable, except we cannot find out. If I listened to the chairman correctly, he cannot get data on what is low cost, what is high cost, what is the experience, what is not the experience, what is the loss factor, how many suits are filed, how many are settled. If you do not have that data base, and apparently the chairman says we do not have it in a reliable fashion, how can we then suggest that we have too few small companies, too few big ones, or conversely too many big ones, too many small ones? We cannot make those judgments, Mr. Rule, without the data. And I think that is what the chairman, in his opening statement today, is looking for. Where do you get the reliable numbers?

Mr. RULE. I understand the need to have reliable numbers, and it is always better to have good data, accurate data, than to not have it. But I think that we would be misleading ourselves if we thought that we could figure out how many companies we need, or how many there ought to be.

Part of the benefits of the market and part of the benefits of the insurance industry—and obviously they have got their problems, and there are some concerns there—is that they have developed some cooperative arrangements that have enabled new competitors to come in and to compete with the bigger fellows.

Mr. MAZZOLI. I appreciate that very much, and I agree. I think you could make a good theoretical case. But it seems to me that if you make that case persuasively for insurance, then you better open it up by saying that we ought to exempt automobiles from antitrust because we are going to make sure Packards stay alive, and Dodges stay alive, and Hup mobiles stay alive, or extend it to plumbing manufacturers so that all of them stay alive, and you expand it.

You know, you are into a little bit of treacherous water by saying that the existence of these exemptions helps to protect a proliferation which yields some sort of economic good because we cannot prove that there is economic good.

Mr. RULE. Let me apologize if I led you to that conclusion.

My view is that the antitrust laws right now—if there had not been this exemption and if the industry engaged in much, if not all, of this cooperative activity that they are engaging in, I think they would be found not to violate the antitrust laws.

Mr. MAZZOLI. You say that because of the State action doctrine.

Mr. RULE. No; I also say that because of a series of cases that the Supreme Court has decided.

Mr. MAZZOLI. The way they function.

Mr. RULE. Right.

Mr. MAZZOLI. Mr. Chairman, if you would indulge me just one more second, I would like to pursue one other question with Mr. Rule. And I think Mr. Oliver is lucky that he does not have anything to do. He can sit back and kind of watch this thing transpire. Next year, if he ever gets any authority, he will not be able to sit there so casually.

I am not an antitrust expert and I yield to you. But I am intrigued by what you say on page 8 of your statement because it would appear that we have this circuitous reasoning that the State action doctrine of the *Southern Motor Carrier* case seems to suggest that if the State does regulate insurance, therefore, there is some standing for the insurance companies to be protected by antitrust.

I don't understand exactly how this thing gets together, but it does lead me to the question: If we got rid of the State control over insurance, that is with respect to its taxation and with respect to regulation, would that not then open up this whole thing to, say, get rid of antitrust exemptions flatly because then the State will not be regulating it and the State action doctrine is mooted?

Mr. RULE. Well, clearly, if you preempt the States from regulating the business of insurance, which we could go into, but it seems to me that that is a really bad idea, but if you did that, then the States could not regulate. And therefore there would be no basis for a State action doctrine.

Mr. MAZZOLI. Right. Now, you say that is a bad idea. Yet, there is at least one Senate bill that would recommend this bad idea. And there are a lot of people who, at least, considered it among many solutions.

May I ask you, simply, why you think it to be a bad idea if we were to remove State control, which then eliminates the exemption from antitrust. We have the insurance industry in the same ball park as automobiles, as people who make plumbing fixtures or people who build houses or anything else?

Mr. RULE. Well, that is true although, for example, to some extent, the manufacturers or the sellers of plumbing fixtures in a particular State can be regulated by the State.

Mr. MAZZOLI. From a safety standpoint—safety, public health and things like that.

Mr. RULE. Right.

Mr. MAZZOLI. But not the way they do their business.

Mr. RULE. Let me put it this way. I am a strong believer in the benefits of federalism. And there may be in tort law—certain aspects of it—an example of cases where you deviate from that. But as a general matter, federalism has, I think, served this country well. It served it very well in the area of corporate law. It served, I think, very well in the area of insurance. In fact, some of the advances that have been made in insurance regulation have been a result of the experiments that have been allowed by federalism, different States trying different approaches.

If you go to one single national system of regulation, you in effect snuff out all that experimentation. You snuff out the benefits of allowing different groups of citizens to decide for themselves how they want to be regulated rather than having that imposed as a result of some decision in Washington.

It seems to me that those are benefits, and those are benefits that we should not lightly throw away. And indeed, I think we should not throw them away.

Mr. MAZZOLI. Thank you very much.

Thank you, Mr. Chairman.

Chairman LAFALCE. Mr. Rule, you are an attorney. Mr. Oliver, are you an attorney?

Mr. OLIVER. I am.

Chairman LAFALCE. My question is a legal one. In my conversations with the insurance industry over the past decade, they were initially adamantly opposed to touching McCarran-Ferguson. Now I do not perceive them as adamantly opposed. I think they think, OK, they started exploiting the liability insurance crisis in order to have precipitous increases to make up for their poor cash-flow underwriting practices. They then thought that they could use that crisis as a means of bringing about draconian changes in the tort reform law. Then they saw that that was boomeranging on them, and to ward off too much of a boomerang effect, they said, well, maybe the antitrust exemption in McCarran-Ferguson does not mean that much. Maybe we ought not to oppose its repeal or modification all that strongly. If we could get away just with that, maybe it wouldn't be too bad.

So, some of them are now talking about the details of what that law should be. They are saying, don't repeal the exemption because there is a certain type of activity we surely have to do. And don't do what you, Congressman LaFalce, are talking about and maybe Justice is talking about, repeal the exemption with certain exceptions for certain types of activities which are clearly, if not necessary, desirable. The collection of certain data, for example, and the sharing of that data, which I think is the approach you and I are going to take.

They are saying leave the law as it exists, but create exemptions to the exemption. In other words, we have an exemption for the insurance industry from antitrust laws, but exempt certain types of activities that you want to proscribe from that, such as rate-fixing.

What problems would you see with that approach, if any, Mr. Rule or Mr. Oliver?

Mr. RULE. Well, I'll start. Anytime one tries—and it is a difficulty that I think we'll run into in trying to help you, but it is certainly a difficulty that you would run into here—to describe a certain conduct that will be proscribed under the antitrust laws, there, I think, will be very serious difficulties. I am not exactly sure if you said rate-fixing. I doubt seriously if you put that in the statute, they would be satisfied with that because——

Chairman LAFALCE. It gets to be a question of to whom are you going to give the benefit of the doubt, the public at large or the insurance industry?

Mr. RULE. I suppose that is one way to do it. But it would be very difficult to define it.

One thing I should note is that the McCarran-Ferguson Act as it is written right now does, to some extent, employ that approach because it does provide a general exemption for the insurance industry except where there are boycotts, coercion, and intimidation.

Chairman LAFALCE. Did you have some questions?

Mr. FLAKE. No.

Chairman LAFALCE. Mr. Oliver, we want you to, at least, be able to look at the practices of the insurance industry. But of what value is that going to be if, (a) you don't have data, because you cannot make a very good study without data, and (b) you cannot recreate that data? I mean, it would take you years and years and years to try to accumulate enough data that was very meaningful. The efficacy of any study you make is going to be in large part dependent upon your ability to access whatever data that presently exists. Correct?

Mr. OLIVER. I would think not necessarily; no. I could give you an example.

Chairman LAFALCE. Well, not necessarily, but in large part, wouldn't you say that if you couldn't access data that your studies would not be——

Mr. OLIVER. It would depend on what we were studying. Let me give you an example.

It is said, and I think correctly, that there are lots of insurance firms in the Nation. I think the figure is 1,000 or maybe it is 1,300. I don't know. And that therefore, the industry is—because it is fragmented, collusion is very difficult. And I think there is a lot of truth in that. But it might turn out that in a particular area, let's say Tennessee, there might only be two companies writing medical malpractice. Indeed, I think that was the case a few years ago when we had a case there. In that particular localized area, therefore, the argument that the industry is so fragmented that collusion would be impossible would strike me as not being true. And that is a study that we could undertake that wouldn't involve data at all.

Chairman LaFalce. To be sure, there are some studies you could undertake that would not necessitate that much data. But let's take, for example, the study mandated by the recent Senate bill. Now, wouldn't you need a great deal of data for that?

Mr. Oliver. I would expect that we would need some, yes. Without sitting down and discovering and determining the kinds of things that the economists would look at——

Chairman LaFalce. My point is——

Mr. Oliver [continuing]. Data is certainly useful.

Chairman LaFalce. I do not think it is going to be good enough to simply repeal the prohibition. I do not think you are going to be able to do that much without an adequate enough data base that you could access, not one that you can create, necessarily, by yourself.

And I am wondering whether or not the Federal Government should be able to collect data in the future, whether the Federal Government should articulate for the States the type of data that they want the states to gather, or whether there might not be some legal way, Mr. Rule and Mr. Oliver, to amend the McCarran-Ferguson law to permit the data collection activities of an entity such as ISO and to make that data available past, present, and future to appropriate officials within the Federal Government.

What are your thoughts on that? I know this is an off-the-cuff opinion, and this is not going to be the official position of the FTC, or the administration, or even your own binding position.

Mr. Oliver. Do we know it is not available?

Chairman LaFalce. Well, right now it is only available to the extent that ISO might want to make it available to you. It is only available to the extent the insurance companies want to make it available to you. If they want to and have it, I suppose there is no problem. But to the extent that they do not want to provide the data, it could present problems.

Mr. Oliver. I guess I would be inclined to find out if there was a problem before we legislated to solve it.

Mr. Rule. I think that is a good answer.

The one thing I should add is that if there were—and indeed, now where, for example, there is an allegation or a reason to believe that there may be—a boycott going on, we do have powers where it is appropriate to use compulsory investigative demands to, in effect, get the information from third parties, as well as the parties to a particular activity.

Chairman LaFalce. When what conditions exist?

Mr. Rule. Where, for example, we are conducting an investigation that we think may lead to some civil prosecution or something of that sort. We have the right to send out compulsory demands that folks have to respond to for information. We can send out interrogatories and document requests.

Chairman LaFalce. You can't send out compulsory demands, though, unless there is a certain set of conditions that exist. Correct?

Mr. Rule. Right.

Chairman LaFalce. It can't be purely for an academic investigation.

Mr. Rule. That is right.

Chairman LAFALCE. It has to be for some criminal investigation.

Mr. RULE. That's right. No, no; a civil investigation.

Chairman LAFALCE. All right, some possible violation of the law.

Mr. RULE. Right.

Chairman LAFALCE. Wouldn't we want to have the ability to have access to information, not proprietary information dealing with a specific company, but aggregate information for the insurance industry without pursuing either a criminal or a civil suit?

Mr. RULE. Well, as a policymaker, which you are, there is a reason to want to have the best information you can obtain in making your decisions. And I think that is right. I think there would be a little bit of concern though if the Federal Government started passing statutes that required private parties to provide information on a general basis.

Chairman LAFALCE. But if that information is already provided to an entity such as ISO, for example, and if the States are collecting data, but it is not uniform enough and not meaningful enough—I mean, the banking industry has to provide data all the time to the Federal Government.

Unfortunately there is a vote, and I am going to have to rush in order to make it. I want to thank Mr. Rule and Mr. Oliver. I think this has been a very good hearing. And I appreciate your appearance today, and I would appreciate, even more so, your cooperation in the endeavors of the committee in the future. Thank you very much.

[Whereupon, at 11:09 a.m., the committee adjourned, subject to the call of the Chair.]

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